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Old Friends - New Realities: California's Economic Relationship with Hong Kong and Taiwan and Trade Policy Report

California Commission for Economic Development

Advisory Council on Asia

老朋友

OLD FRIENDS - NEW REALITIES

新狀況

California's Economic Relationship with Hong Kong and Taiwan and Trade Policy Report

California Commission for Economic Development

Lieutenant Governor Leo McCarthy, Chairman

Advisory Council on Asia

December 1990

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State of California
Commission for Economic Development

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One of history's lessons is that economic success can be a very fragile achievement. The prosperity of a state or nation does not automatically maintain itself. It requires vision and planning. It demands that we continually reassess our view of the world and our role in it.

These ideas were reconfirmed last year during my trip to the Asia-Pacific region including Hong Kong and Taiwan. I was struck by the area's new maturity and self-confidence. It is a region where change is incredibly rapid, where resourcefulness and ingenuity are valued and where opportunity is real not just imagined.

Since that visit much of the region has continued to evolve both politically and economically. I wish I could say that all developments have been positive. Events in China have unfortunately dampened some of the original optimism which characterizes Hong Kong and fuels our economic relations. I can only hope the pendulum will swing back before long.

And what of California's role in the future of the Pacific Rim? I believe it is up to us to make sure that the changes occurring in Asia work to the advantage of both societies. Trade and investment must flow both ways. Barriers must be relaxed. We must find a way to reward creativity and the competitive spirit within our workforce. And certainly our educational system must reflect the important economic and cultural links we have with Asia.

In this regard I am pleased that the Advisory Council on Asia of the California Commission for Economic Development wishes to take a leadership role. Its first report focusing on Hong Kong and Taiwan illustrates special insights into the problems and promise of these two developing economies. It also presents a number of specific policy recommendations to keep California competitive.

I believe in the promise of the California-Asia economic relationship, but I know it will not happen by chance. We can afford neither complacency nor outmoded ethnocentrism. If we are willing to take risks and to reevaluate our ideas in a constantly changing environment, the rewards on both sides of the Pacific can be enormous.

Leo McCarthy

LEO McCARTHY

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PREFACE

Last year the Advisory Council on Asia (ACA) was asked by Lieutenant Governor Leo McCarthy to conduct a fact-finding mission to Asia. We believed, as he did, that the pace of economic and political developments in the region was reshaping Asia so quickly and so profoundly that the attention was warranted. As members of California's Asian community and business people involved with Pacific Rim commerce, we believed we could make a major contribution in assessing these developments and their importance to California.

We had not anticipated, however, that our mission would provide the impetus for a series of reports documenting fundamental changes in the economies of the region, or that this work would be far more extensive than originally envisioned. We have also had to rethink some of our conclusions regarding the economic future of the region in light of the tumultuous events in China.

The scope of this work was also expanded in another way. We recognized the need to make it as much a policy guide for government officials as a working document for those involved in Asian commerce.

For its first report the ACA focuses its attention on two of the so-called "four tigers" of Asia -- Hong Kong and Taiwan. Although they have much in common, including history and culture, they are nonetheless two very distinct economic and political entities at different junctures in their development.

We do not presume to have all the answers for improving our prospects for trade and investment with Taiwan and Hong Kong, but we do feel we have made a contribution through this effort. Above all the ACA is fundamentally dedicated to the furthering of California's ties with Asia. The ties are real; they are lasting, and they are critical to California's economic stability. We thank the Lieutenant Governor for allowing us the opportunity for this fact-finding mission.

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ADVISORY COUNCIL ON ASIA

The Advisory Council on Asia (ACA) was created in 1986 and is a permanent committee of the California Commission for Economic Development. It is charged with the responsibility of examining and recommending specific policy positions on California's economic relationship with Asia. Based upon the Advisory Council's recommendations, the Commission may issue reports designed to provide California's public and private sectors with official proposals, guidelines and assessments of California-Asia business.

The policy documents issued by the Advisory Council on Asia are disseminated to a broad spectrum of leaders in government agencies and private businesses throughout the state. The reports are intended to be used to enhance California's competitive position in Asia and promote economic cooperation, understanding and mutual development between California and its Asian trading partners.

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The Advisory Council on Asia acknowledges the work of Ed Fishbein who compiled much of the original research and participated in the ACA trip to Hong Kong and Taiwan in 1989.

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EXECUTIVE SUMMARY

OVERVIEW

The Advisory Council on Asia's report on Hong Kong and Taiwan represents an effort to put into focus the possibilities of increased trade and investment between California and two of the most vital of the emerging economies of the Pacific Rim. The Advisory Council believes that both should be viewed as essential to California's continued economic vitality and as links to the state's present and future economic relationship with the rest of Asia.

Californians must take steps now to nurture carefully these ties while continuing to reevaluate them within the context of rapidly changing political and social developments. Some of these developments, particularly the relaxation of trade barriers by Taiwan, have been positive and increase the likelihood of greater flows of two-way trade and investment. Other developments, most notably China's retreat from democratic reforms, could have ominous repercussions for Hong Kong. Only time will tell. Nevertheless the Advisory Council on Asia believes that the opportunities are real for Californians who are willing to make a long-term commitment in both Hong Kong and Taiwan while understanding that there are always potential risks.

The Council also believes that state and federal policies need to be reevaluated to allow greater participation in the dynamic changes occurring in the Asia-Pacific region. Federal and state policies on taxation, education, immigration and export promotion and assistance need to be made more responsive to the changes occurring in the global economy. Without such reevaluation and renewed commitment, California, like the rest of the United States, will be unable to compete effectively in the increasingly more complex and demanding arena of international business.

I. HONG KONG

The territory of Hong Kong -- the 11th largest trading economy in the world -- is still an extraordinary place for the transaction of global business and likely to remain so for the foreseeable future. With over 900 U.S. firms already operating in the British colony, and many more contemplating commercial ties, our relationship is firmly established. What fundamentally sets Hong Kong apart from many of the other economies of the region are three unique characteristics -- its economic resourcefulness, its truly open and highly sophisticated business environment and infrastructure, and its increasingly intimate relationship with the nation to which it returns in 1997 -- the People's Republic of China.

Collectively, these distinctions offer exceptional opportunities for California businesses -- opportunities that are not close to being fully realized. However, it is equally true that this optimism must be tempered in light of recent political developments in China.

The Economy: Opportunity and Risk

The opportunities in Hong Kong are rooted in one of the great economic transformations of the postwar world. The Hong Kong of 30 years ago bears little resemblance to the economic giant we now know. Today, it is a world class center of light manufacturing and high finance with a 1989 GDP of $63 billion. Thirty years ago, Hong Kong was a footnote in the economic ledgers of the United States and California. Today, it is a major source of imports for our nation and state and a major recipient of corporate investment from every corner of the world. It is also, despite its small size, the 10th largest market in the world for California-made exports and could be even more important in the future.

Now, Hong Kong is entering a new phase in its economic development. As wages rise, Hong Kong's manufacturers are diversifying, moving into more sophisticated products. As competition from cheaper labor markets increases, its factories are automating. And as China and Hong Kong inevitably grow closer, the territory is moving more and more of its labor-intensive work to the People's Republic. The relationship with China, however, is also the source of the risk of doing business with Hong Kong.

Yet even within this context, a number of developments indicate that opportunity outweighs risk. For example, the Bank of America just this year moved its Asian headquarters to Hong Kong. It is just one of 20 U.S. banks and 56 foreign banks with offices in the territory. In addition the state of California opened a trade and investment office in Hong Kong only last January. These actions were not taken without careful consideration of all political and economic factors. The fact that the United States is Hong Kong's leading market for domestic exports -- $9.25 billion in 1989 -- reinforces the strong links that exist between the two. The remarkable stability of the HK dollar during 1989 and mid-1990 is also encouraging to U.S. and California businesses wishing to develop or expand commercial interaction with Hong Kong.

Hong Kong and China

The single most important factor influencing Hong Kong's future is the transfer of control from Great Britain to China in 1997. No one knows for sure what that change will ultimately mean for Hong Kong's economic development and stability. However, China has pledged to maintain Hong Kong's economic system for 50 years under a "one China, two systems policy." Most business people and government officials with whom the Advisory Council met believe China will honor its commitment.

One thing is clear for all parties -- changing that system would have a profound and negative effect on China as well as Hong Kong. China and its leaders are acutely aware of the developing symbiotic relationship with the territory and with the need to keep Hong Kong economically viable. In many respects the PRC's new Bank of China building -- the tallest and most conspicuous of the territory's skyscrapers -- is also the most demonstrable symbol of that close relationship and interdependence. Today there are more than 2,000 PRC companies operating in Hong Kong, and they are involved in every facet of the economy. In 1989 Hong Kong business with China was valued at $43 billion making it Hong Kong's leading trading partner. Clearly this relationship is too important to both to be undermined by political instability, hard line dogma and inflexibility.

In nearby Guangdong province, for example, about two million people are working for Hong Kong manufacturers. Many economic observers expect the relationship to grow substantially. Hong Kong firms will concentrate more and more on research and development, the production of sophisticated product lines and finance. Their Chinese counterparts will take on much of the labor-intensive assembly work.

China's expanding relationship with Hong Kong is also evidenced in the impressive growth of the "re-export" of products made in China but shipped from Hong Kong. It is also a major reason why Taiwan's trade with the mainland through Hong Kong is booming, growing to $3.7 billion in 1989.

The California-Hong Kong Connection

Largely in response to the political turmoil in China, the economy of Hong Kong has slowed since June 1989. Nevertheless, long-term prospects for California-Hong Kong business remain good. Latest California statistics indicate that Hong Kong bought nearly $1.2 billion worth of California goods in 1989, making it our 10th largest export market. In addition it is an increasingly important base from which U.S. and California-based firms manufacture products for the American market.

Hong Kong's economic maturation and greater concern for its "quality of life" are also creating new commercial opportunities in areas ranging from computers to upscale food products, from health care to pollution control.

For California businesses in Hong Kong two other considerations are important. First, Hong Kong is considered a "springboard" to participation in the mainland Chinese economy of limitless potential under the right circumstances. Second, it is still the traditional gateway to the rest of Asia which accounts for 60% of its total foreign trade.

As previously mentioned, the opening of a state of California office in Hong Kong early in 1990 and the decision of the Bank of America to relocate its Asian headquarters to Hong Kong in early 1990 are important indicators that the territory remains a lucrative and stable market for California business.

Investment Prospects

Although the recent downturn in the economy resulting from events in China has temporarily weakened the investment markets -- as well as other sectors of the economy -- there is still growth spurred in part by the Japanese who continue to make impressive acquisitions. In 1989 they surpassed the United States in direct investment -- pouring about $2 billion into Hong Kong for a cumulative total of $8 billion. There are now 50 Japanese banks operating in Hong Kong and 30 securities firms.

The Japanese influx of capital is spurred in part by their interest in the major public sector construction projects being planned. The new airport and seaport projects, for example, will cost over $16 billion between now and 2006. These projects, in addition to plans for new highways, hospitals and universities, also translate into additional business opportunities for Californians. However, they must be willing to take a long-term view on investment and accept some risk as the Japanese appear willing to do. Of particular note for California's rapidly growing environmental business sector is the territory's commitment to invest $2.5 billion over the next ten years on such projects as the overhaul of its sewage system and the construction of three massive landfill sites and refuse transfer stations.

Although the territory continues to attract foreign capital and business, it is equally true that we are seeing increased outward flows of capital. Much of that capital is pouring into the United States and in particular, California. Hong Kong's traditionally open economic system places no real restriction on Hong Kong investors. Between 1988 and 1989 the United States saw a $250 million increase in capital inflow from Hong Kong.

The Labor Shortage and Political Stability

The most pressing problem on the immediate horizon is the growing shortage of skilled technicians and professionals. Many Hong Kong residents apprehensive that China may not honor its commitments after 1997 are opting for emigration. Australia, Canada and the United States have become the favorite destinations of those who have sufficient resources. California is often the preferred destination of those coming to the United States because of its geographic position and large, well-established Chinese community. Currently more than 1,000 people a month leave the territory. Whether this trend will escalate or subside depends in great measure on what happens in China between now and 1997. It is a factor that all investors will have to weigh carefully.

II. TAIWAN

Taiwan, like Hong Kong, is going through a period of profound change. It is no longer the haven of cheap labor and cheap products for exports. Today it must be considered a sophisticated center for global business -- manufacturing, investment and banking -- with unlimited potential. And like Hong Kong it finds itself developing closer economic relations with mainland China. Together these political, economic and social transformations offer new opportunities to California businesses -- if they are willing to pursue them.

Political Change

On the political side, the martial law under which Taiwan was ruled since 1949 has been lifted. The elderly Chinese who had fled the mainland after the communist takeover and ruled Taiwan for the next four decades are now transferring considerable power to younger native Taiwanese. The result is that Taiwan's citizens now enjoy more freedom of expression than ever before.

Economic Changes

While these reforms are important, it is the economic changes that are attracting the most attention from our exporters and investors. Today Taiwan ranks as the 13th largest trading nation in the world and it is the U.S.'s 9th largest export market. Today two-way trade between the United States and Taiwan is valued at $36 billion.

California's commercial relations with Taiwan are equally impressive. Of all the countries in the world, Taiwan is the 8th largest market for California exports. Latest figures indicate that in 1989 alone Taiwan purchased $2.8 billion worth of California goods. Total two-way trade between Taiwan and California is valued at $9 billion -- or 25% of the total trade between Taiwan and the United States.

With an unemployment rate of less than 2% and a per capita GNP of approximately $7,509, Taiwan is entering a new phase in its development. It is moving away from protected, labor-intensive industries and has publicly committed itself to slashing its massive trade surpluses, particularly with the United States. Considerable progress has been made toward achieving this goal. Today that deficit with the U.S. has dwindled from $17.4 billion in 1987 to $12 billion in 1989.

Taiwan is also restructuring its economy in other ways. It is de-emphasizing simple, labor-intensive products like low-cost footwear, inexpensive textiles and basic electronics and developing more complex "state of the art" technologies including sophisticated electronics, computers and high-quality machinery.

Although Taiwan continues to maintain a number of prohibitive import restrictions, its barriers are generally far less stringent than they were even a few years ago. As those barriers continue to fall, and personal income continues to rise, Taiwan's expanding consumer market is creating a growing demand for foreign-made products, agricultural commodities and services. All of these developments generate increased opportunities for California-based industries and agribusiness.

Trade Barriers

As already mentioned, barriers to trade have been substantially reduced. However, before California business can take full advantage of growing market opportunities in Taiwan, still more must be done. U.S. trade officials, while admitting that there has been real progress to open markets, nevertheless contend that tariffs are still excessive and remain particularly high on a number of agricultural and fishery products, some of which are barred altogether. Fresh fruit and processed agricultural products often face ad valorem import duties of up to 40-50%. In addition, the State Department asserts that the importation of a number of agricultural and industrial products continue to be hindered by excessively strict permit provisions, customs procedures, or inspection requirements.

For California agricultural interests, the reduction or elimination of tariffs on agricultural imports could create significant export opportunities where we have a comparative advantage. Fresh fruit exports including apples, pears, avocados, citrus and kiwifruit could rise about $6 million a year, while fruits juices and drinks could add another $3 million. Nuts and dried fruit sales could also increase by $8 million annually as a result of tariff reductions.

With regard to intellectual property rights -- one of the most critical areas for California high technology firms -- U.S. officials acknowledge significant improvement from the notoriously lax environment that existed in the past. However, they contend that problems still remained in a number of areas, including computer software, videotapes, and semiconductors.

Films are also a particularly difficult problem. The U.S. industry claims with justification that its earnings in Taiwan were cut by as much as 50% by the emergence of large numbers of establishments showing videotapes of motion pictures without compensation.

A reduction in tariffs will not by itself open new markets for California products. Savings will have to be passed on to consumers. However, in many instances consumers have failed to recognize any savings as a result of tariff reduction due to an archaic distribution system. Often suppliers and small retail operations are unwilling to pass on price reductions to their customers. Many of these problems are similar to those faced by U.S. exporters trying to penetrate the Japanese market.

New Possibilities for California

In the past, the relationships businesses in California and throughout the United States formed with their counterparts on Taiwan have concentrated primarily on the importation of inexpensive products for the American market. Now there are two additional options. One is to expand exports to Taiwan in a range of areas, from advanced electronics to pollution control equipment to consumer goods and additional agricultural commodities. The other is to build new relationships with businesses in Taiwan as it becomes, like Hong Kong, a "springboard" from which Californians can sell and market goods throughout Asia and ultimately, to mainland China which is fast becoming a major -- if yet unofficial -- trading partner. In this connection, the decision of the Taiwanese government to convert three export processing zones into free trade zones before 1997 is significant and lends greater credibility to Taiwan's claim as a second entry door for trade with the rest of Asia and, in particular, the Association of Southeast Asian Nations (ASEAN).

Today Taiwan's trade with the rest of Southeast Asia totals $17.8 billion, accounting for 15% of its total foreign trade, and it shows every sign of continuing. This potential should have prodded California business people into action. Instead, business, trade and government officials in Taiwan contend that our business people have been slow to take advantage of the opportunities Taiwan, in many cases, is going out of its way to offer.

The Advisory Council on Asia firmly believes that if California and the United States are going to continue to be major players in the international economy, we will have to start seizing these opportunities. The Taiwan domestic market is becoming more open. There are real -- not illusionary -- opportunities for sales in that market from computers to health care services, from pollution control equipment to consumer goods. One especially noteworthy area is the environmental field. It deserves closer attention now that Taiwan is appropriating $33.3 billion between now and the year 2000 for a number of major environmental projects in response to years of neglect when the emphasis was on rapid industrialization. This field alone will create exceptional opportunities for California's environmental industries and consulting firms.

III. A POLICY AGENDA

Recognizing opportunities and actually taking advantage of them are two distinct processes. Yet all of this effort on the part of the Advisory Council on Asia would be of little practical value if we merely document the potential but fail to propose an action agenda through which Californians can achieve commercial objectives. We believe it is absolutely essential that government at both the state and federal levels assist in this process. Government must implement both short- and long-term strategies and policies which help Californians participate in these opportunities instead of merely observing them. Attention must be given to reforms in the area of basic education and current immigration law. All of us must come to terms with our worsening budget deficit. We must admit that our nation's economic woes do not stem entirely from unfair trading practices. We cannot shield ourselves or expect our economy to prosper through protectionism. This is a world which is increasingly without borders.

Recommendations

The Advisory Council on Asia makes the following recommendations as part of its action plan to help California business realize opportunities available to them in Taiwan, Hong Kong and the rest of Asia.

A. STATE LEVEL

1. INCREASE SUPPORT FOR OVERSEAS TRADE AND INVESTMENT OFFICES AND ESTABLISH A NEW OFFICE IN TAIPEI

With a worldwide network of trade and investment offices in London, Frankfurt, Mexico City, Tokyo and Hong Kong, California is positioned to help its business community take advantage of developing opportunities. We propose that California take two immediate actions with regard to overseas representation: 1) double the budgets of the overseas offices within the next two years to allow for additional staffing and services, and 2) establish an overseas office in Taiwan at the new World Trade

Center of Taipei to maximize our opportunities in Taiwan and other areas of Asia.

These two recommendations are based on the Advisory Council's recognition that changes in federal policy in the last eight years necessitate a more active role for states in promoting their own international business interests. Overworked and often understaffed, U.S. embassies, consulates and other U.S. government entities operating in Asia are not equipped to promote California's unique worldwide business agenda. California must do more for itself, and it must take into account that other states are now much more active in Asia promoting their exports and attracting new foreign investment.

With regard to the opening of an office in Taipei, the Council believes this move would assist California firms in taking full advantage of growing export markets in Taiwan and the rest of Southeast Asia while helping to attract additional investment from Taiwan.

2. PLAN FOR THE ESTABLISHMENT OF A NORTHERN CALIFORNIA EXPORT DEVELOPMENT OFFICE

The Office of Export Development within the California State World Trade Commission currently serves the needs of the state's entire export community through a single office located in Long Beach. The office offers a comprehensive list of services to exporters and potential exporters including organizing participation in foreign trade shows and missions, producing California product catalogs, distributing trade leads through an automated trade leads system and receiving foreign buyers missions.

The Advisory Council on Asia believes California's small- and medium-sized exporting firms and potential exporters in Northern California, and particularly Silicon Valley, may be better served by having an office located in Northern California. The Council recommends the Export Development Office begin assessing the feasibility of a second office as part of its general plan to expand its programs and activities. This expansion would be especially important if the U.S. Department of Commerce does not increase substantially its funding for export promotion activities and services both in California and abroad.

3. DEVELOP COMPUTER LINKAGES WITH THE NETWORK OF STATE OVERSEAS OFFICES, THE U.S. AND FOREIGN COMMERCIAL SERVICE AND OTHER TRADE DEVELOPMENT AGENCIES

The Advisory Council recommends that the Office of Export Development implement a plan to link by computer the network of

California overseas offices with its office, the U.S. and Foreign Commercial Service (U.S. & FSC), the California Department of Commerce and the World Trade Commission in Sacramento. In addition it should begin to develop a cooperative agreement with such organizations as the Japan External Trade Organization (JETRO), the China External Trade Development Council (CETRA), and the Hong Kong Trade Development Council (HKTDC) to access and share information via a computer network.

We recognize that instantaneous communication and access to world-wide trade and marketing information are essential in a highly competitive international business arena. We believe that a better system for sharing and providing information to California exporters, as well as potential foreign buyers and investors, could greatly enhance our global business prospects.

4. PROVIDE FULL FUNDING TO THE EXPORT FINANCE PROGRAM AND EXPAND THE OFFICES IN SAN DIEGO AND NORTHERN CALIFORNIA

The original legislation creating the California Export Finance Program and fund was passed in 1985. At the time the Governor signed the bill, he reduced the $10 million appropriation to $2 million, indicating the amount was sufficient until the program had proved itself. Since then, the fund has received several augmentations and now stands at $5 million.

The program has an outstanding record of achievement in its five years of operation. By providing loan guarantees of 85% up to $588,000 per transaction, or $1,176,000 in conjunction with the U.S. Small Business Administration, it has assisted California's small and medium-sized businesses secure bank financing for export transactions that normally would not have been funded without a state guarantee. To date the CEFO has supported export sales of more than $240 million by industrial, commercial and agribusiness enterprises. It also provides much needed counseling with regard to bank financing, foreign country credit worthiness and appropriate state and federal financial programs, including Eximbank.

We believe the program has demonstrated its usefulness and deserves to be fully funded at $10 million.

In addition, the Council recommends that the World Trade Commission take steps now to expand the CEFO in the San Diego area and Northern California. We support making the San Diego office a full-time operation so it may handle the volume of business being generated by the high-tech and bio-tech industries in the San Diego region. We also propose that the two-person staff in the Northern California branch of the CEFO be increased to permit the hiring of a staff person who would work primarily with Silicon Valley firms.

5. <u>RECRUIT THE TALENT OF CALIFORNIA'S ASIAN BUSINESS COMMUNITY</u>

California should take better advantage of one of its least-utilized resources -- its large and growing Asian-American community. This talent base can help California build stronger commercial relationships with the business communities of the Pacific Rim and help educate Californians about opportunities that exist in Asia. Many members of the Asian community have the business skills, cultural understanding and language facility that make the difference in international commerce. For example, members of the Chinese-American business community have substantial ties with Taiwan, Hong Kong and other areas of Asia. Their expertise and skills should be tapped as should the talents and strengths of other Asian-Americans with similar relationships to other nations in the Pacific Rim.

As a first step we recommend expanding the trade development function of the Advisory Council on Asia. This expanded function would include assisting state agencies and our private sector in identifying new market prospects in the Pacific Rim and proposing strategies that would allow California's business community to tap into these opportunities. As a first step we propose that the Council coordinate an environmental trade mission in 1991 to Taiwan and Hong Kong to acquaint California's environmental consulting firms and related businesses with the opportunities which exist for them in this market.

Taiwan has already committed $33.3 billion between now and the year 2000 for environmental projects to compensate for years of neglect and growing concern over worsening conditions including ground, water and air pollution. Hong Kong officials have also placed greater emphasis on environmental quality, pledging $2.5 billion during this decade to alleviate pollution problems.

The Advisory Council also proposes to develop closer working relationships with members of the California State Legislature and Congress to help ensure the implementation of sound trade policies and the avoidance of protectionism.

6. <u>CONFORM STATE TAX LAW TO FEDERAL LAW WITH REGARD TO THE TREATMENT OF SMALL FOREIGN SALES CORPORATIONS (FSCs) AND ESTABLISH A STATE-SPONSORED "SHARED" FSC</u>

U.S. Department of Commerce studies indicate that less than 10% of all domestic manufacturers that could export actually do. This is an appalling statistic. We believe that state tax policy can play an important role in stimulating exports, particularly by small and medium-sized companies. To encourage our exporters and potential exporters the state should consider conforming state and federal laws with regard to the treatment of small

Foreign Sales Corporations. This action would allow California's small- and medium-sized firms a 15% state tax exemption on export profits.

Secondly, the California State World Trade Commission should consider establishing a model "Shared" Foreign Sales Corporation similar to one operated by the state of Delaware. Shared FSCs have additional benefits for smaller firms, allowing up to 25 companies to band together and share start-up costs and maintenance. The state as the coordinating agency maintains a supervisory and advisory role in the shared FSC, marketing the program and guiding the companies which wish to participate, while not actually becoming involved in the export businesses.

We believe a shared FSC would be an appropriate complement to other commission programs including export finance and export development.

We would also like the commission to review other similar programs. For example, the commission could develop a cooperative program working with cities, counties or other regional bodies or trade associations to implement one or more "shared FSCs" in the state. The commission could do the statewide marketing and contract with other entities to assist local companies interested in utilizing this mechanism to make exporting more profitable.

We recognize that some of these proposals have already been considered by the State Legislature in 1988 in a bill by proposed by Assemblywoman Lucy Killea (now State Senator Killea). At that time it did not have sufficient support in the Legislature, and there was concern over it's fiscal impact, estimated by the Franchise Tax Board at $11 million in FY 1990-91. However, we believe that any temporary loss in state tax revenue would be offset by new revenues generated by increase export transactions in coming years.

7. INTERNATIONALIZE THE CURRICULUM AND PLACE GREATER EMPHASIS ON SCIENCE AND MATHEMATICS

To prepare the next generation for a vastly different and much more competitive world, we must make our youth internationally minded. Toward that end, we call for (1) expanding specific studies which would allow our future business people to participate fully in the international business community and (2) incorporating into the existing curriculum a global framework, in other words, promoting an "international mentality" among our young people.

Increased emphasis must also be placed on foreign languages -- particularly Asian languages -- and more attention must be given to geography, science and math. We also propose taking a hard look at how to lengthen the school year, so our students receive as much instruction time as their foreign peers. We fully recognize the costs associated with these reforms but believe that this kind of commitment is absolutely essential to California's future.

Specifically the Advisory Council on Asia supports the following:

-- Full funding for 18 teacher resource centers which provide teachers with the tools and resources to internationalize the curriculum.

-- Restoration of $950,000 vetoed by the Governor in the 1990-91 budget to fund the existing nine teacher resource centers.

-- Increased emphasis on Asian languages and geography at all levels in our educational system.

-- Additional mathematics and science study on a par with our major foreign competitors to prepare students for a much more technology-based work environment in the 21st century.

-- Lengthening of the school year from 180 to 220 days.

-- Increased use of student interns in state agencies involved in international commerce.

8. IMPROVE INFRASTRUCTURE

No world class economy can sustain its position without the proper infrastructure. International trade requires, among other things, first class air and sea ports as well a sophisticated and well-maintained highway system. California must continue to modernize the infrastructure which supports international commerce throughout the state.

Consolidated Transportation Corridor (Alameda Corridor)

The Advisory Council supports plans for a $500 million program of highway and railroad improvements between the San Pedro Bay Ports and downtown Los Angeles. We believe it is a project which will greatly facilitate port access and expansion while lessening highway traffic congestion, air pollution, vehicle delays at grade crossings and train noise in residential areas.

We believe it represents a commitment to keep pace with the demands of international commerce through our ports by connecting the economic center of the San Pedro Bay Ports -- the largest port complex in the nation -- to the interstate highway system and national rail system.

We believe that the project will permit the implementation of the "2020 Plan" -- a $4 billion program to expand the land and terminal areas of the Ports of Long Beach and Los Angeles and in general increase economic activity throughout Southern California.

B. FEDERAL LEVEL

9. EXAMINE THE IMPACT ON THE CALIFORNIA ECONOMY OF THE IMMIGRATION REFORM ACT OF 1990

California is already the most ethnically and culturally diverse state in the nation and home to over one-third of the nation's Asian-Americans. The passage this year of a major immigration reform bill has significant implications for the California economy and the state's Asian community.

Two provisions of the new law are of particular interest to the Council. The first one would establish a special "investor" visa category (10,000 annually) for foreigners investing $1 million in new-job creating businesses (or $500,000 in rural areas with high unemployment). The second provision increases to 25,000 annually the number of visas available for immigrants from Hong Kong. It also allows for an additional 12,000 visas for residents of Hong Kong who are employed by a U.S. business.

The Advisory Council intends to undertake a major review of these reforms and innovations in immigration policy to determine how they may benefit California and be incorporated into the state's overall economic development strategy. Of special interest to the Council is stimulating job creation in areas where there is excessive unemployment or underemployment.

CALIFORNIA-PACIFIC YEAR 2000 TASK FORCE RECOMMENDATIONS:

The Advisory Council on Asia has reviewed and strongly endorses a number of federal-level recommendations contained in California and the Pacific in the New Century: A Strategic Plan for Success by the California-Pacific Year 2000 Task Force. Among its recommendations, the Advisory Council singles out the following for greater emphasis:

10. INCREASE STAFFING AND SUPPORT OF THE U.S. AND FOREIGN COMMERCIAL SERVICE, INTERNATIONAL TRADE ADMINISTRATION

The Advisory Council on Asia strongly recommends increased staffing of the U.S. Foreign and Commercial Service of the International Trade Administration -- the Commerce Department's leading source of information on foreign markets and export opportunities. Budget cuts have dramatically reduced the ability of these offices to function effectively and provide timely information and assistance to our exporters. In particular we are concerned about the lack of personnel in the four California offices of the ITA. It is insufficient to handle the volume of inquiries and requests for information from our business people.

Such shortsightedness does little to make us more competitive or to increase our share of foreign markets. Compared to similar agencies of foreign governments, like CETRA (Taiwan) or JETRO (Japan) or HKTDC (Hong Kong), our efforts are mediocre at best.

11. REDUCE THE BUDGET DEFICIT

The Advisory Council on Asia, like the California-Pacific Year 2000 Task Force, recognizes that our ability to participate effectively in international commerce is being seriously hampered by our failure to deal with our massive federal budget deficit. No other single issue has such an adverse impact on our present and future economic viability and our international competitiveness. We may make short-term gains in exports but no long-term economic gains and improvements in our basic quality of life can be realized or sustained until we confront this issue.

12. INCREASE RESEARCH AND DEVELOPMENT

We believe that California, and the U.S. in general, will lag behind in the production of new technologies without additional spending for research and development. Countries like Japan are willing to invest much more on a per capita basis for R&D than is the United States. We believe such policy is ultimately self-defeating.

We support the proposals of the California-Pacific Year 2000 Task Force to create (1) an "Advanced Civilian Technology Agency" to assist the private sector to develop strategic technologies that are commercially viable, and (2) a "Technology Corporation of America" to promote the development of sophisticated, high-technology industries.

13. CONTINUE EFFORTS TO OPEN FOREIGN MARKETS

The Advisory Council believes that our federal government, and especially the Office of the United States Trade Representative (USTR) must continue to challenge unfair trading practices. There is no doubt that they contribute to our continuing trade deficit. And, there is little doubt that the forceful action of our trade officials has been responsible for removing many trade barriers. Provisions of the Omnibus Trade and Competitiveness Act of 1988 have given us additional tools in this regard, for example, the "Super 301" provisions. In addition, the Advisory Council on Asia believes that California must maintain effective communication with federal trade officials and its Congressional delegation letting them know how California industry and agribusiness are impacted by the trade practices of other nations.

CONCLUSION

The Advisory Council on Asia believes California business has only begun to tap the surface of opportunities in the Pacific Rim. Getting below the surface will be hard work and will demand that business and government work cooperatively. We have been fortunate to have close and mutually beneficial relationships with both Taiwan and Hong Kong. The challenge we face today is to adjust to new economic realities in the region so that these relationships can continue to expand and prosper.

INTRODUCTION

Beginning in 1989 with its fact-finding mission to the Far East, the Advisory Council on Asia (ACA) of the California Commission for Economic Development began to focus its attention on how best to improve trade relations with its important Asian trading partners. The Council recognized that California already has well-established economic, cultural and social ties with many nations in the Pacific Rim and that these ties undoubtedly are fostered by California's own vibrant and growing Asian population. The Council also recognized, however, that much more could be done to strengthen the state's trading relationships during the last decade of the twentieth century.

As a first step in this process the Council has focused its attention on Hong Kong and Taiwan -- two of the most dynamic of the emerging economies in the region. The Council took into consideration that only one year ago Taiwan and Hong Kong, along with Singapore and Korea, were removed from the General System of Preferences (GSP). That action was particularly noteworthy for the Advisory Council on Asia. The GSP program, designed to promote economic growth and industrialization in developing countries, is based on the idea that temporary duty-free tariff preferences which help developing nations to compete globally are a key to sustained economic development. The removal of these countries from our nation's GSP list denotes their significant economic maturation. The ACA believes that, given the nature of their economic achievements and the potential for increased California trade and investment flows, Taiwan and Hong Kong are indeed worth closer scrutiny.

The ACA has taken a long-term view of its work. In the months following its fact-finding mission, the Council has met to discuss political and economic developments in Taiwan and Hong Kong, assess opportunities and risks in export development and investment, and establish its own policy agenda and advisory role. At every step in this process the ACA was mindful that nothing in Asia remains static for long. Events such as the Tiananmen Square tragedy in China which occurred after the ACA's fact-finding mission reinforce this point. Similarly the recent relaxation of some trade barriers and political reforms in Taiwan are changing the way we do business there and offer great opportunity.

Yet, it is precisely these kinds of developments that have made the task of the ACA that much more difficult and complicated. For example, the reversion of Hong Kong to China in 1997 which seemed to be progressing smoothly now faces new anxieties and challenges in light of China's recent political turmoil and retreat from democratic reforms. Still, the Council believes that it would be both shortsighted and naive to underestimate the resourcefulness and economic vitality of Hong Kong and its people and to downplay its importance as the financial hub for all of Asia.

Complicating this study even further is our own federal budget and trade deficits. Many of our trading partners have told us quite frankly that we must put our own house in order rather than resort to protectionism -- in effect blaming other nations for our current economic problems. There is much truth in this statement, although we recognize that the unfair trading practices of other nations are real obstacles which often make it difficult for us to compete effectively in the global marketplace.

On the positive side, our nation's economic growth has been fueled to a significant degree by exports which create new jobs and opportunities in many sectors -- manufacturing, agriculture and a host of service areas. This is especially important for California which is so dependent on international commerce.

The ACA believes that state assistance in export promotion and in making small business aware of potential export market opportunities is essential. Seizing opportunities for joint ventures and job-creating foreign investment can also help to energize our state economy.

All of these factors were considered in defining the scope of this project. The Council concluded that the study should serve two distinct yet complementary purposes and audiences. First, the report should be a practical resource for business people who need reliable information and data to determine the best prospects for increasing exports and investment opportunities. Much of what is contained in this report is based on meetings members of the ACA had with government officials and business leaders in Asia -- individuals who are knowledgeable about Asian business opportunities and who were willing to share their knowledge and expertise with the members of the ACA. Second, the report should serve as a policy guide for government officials who are responsible for the overall direction of both state and federal international trade policy and promotion and for setting U.S. foreign policy objectives.

This report realistically acknowledges many of the dynamic changes occurring in Asia. In addition, it reflects the ACA's commitment to the fostering of mutually beneficial California-Asia business ties. What is critical for California as the leading export state in the nation and the largest recipient of foreign investment is how we as a state react to global changes. Just as important is how we develop and implement policies that allow government and the private sector to work toward the achievement of mutually desirable objectives. With so much attention now focused on Eastern Europe and with "Europe 1992" a common "buzz" word, the ACA believes a balanced approach to world trade is essential. We cannot afford to overlook the obvious. Given California's location, longstanding economic and cultural ties with Asia and growing Asian population, its economic future will be inextricably linked with the emerging economies of the Pacific Rim.

HONG KONG'S CHANGING ECONOMY
An Assessment

For close to three decades the people of Hong Kong have been writing one of the great economic success stories of the postwar era. Its success is not just the fortuitous result of geography. This tiny British colony's entrepreneurial spirit, talented and industrious workforce, indefatigable confidence in itself and ability to thrive within the context of two very distinct cultures have all contributed to its greatness. Today those qualities are being put to a severe test by a number of recent economic and political developments, including increased competition from other Asian nations, a growing labor shortage and its inevitable reversion to China in 1997.

A Diversified Economy

No one doubts that part of Hong Kong's success stems from a diversified economy built around world-class light manufacturing, financial services and a port that serves as a gateway to all of Asia. That economy capped off decades of success by growing 30% in the three-year period from 1986-89.[1] With a GDP of $63 billion in 1989, Hong Kong is a formidable economic power and is likely to remain one for the foreseeable future.[2] However, it is likely to be a different kind of Hong Kong in the last decade of the 20th century.

Image and Reality

The old image of Hong Kong is giving way to some new realities. The "real" Hong Kong is not a manufacturing center of inexpensive goods. Today it is the sophisticated service sector which sparks the economy. This sector makes up about 75% of the bulk of Hong Kong's GDP. On the other hand, direct manufacturing while still very important has declined to about 20%.[3]

The old image of low wages has likewise vanished. Thirty years ago, many of Hong Kong's residents were happy to work for subsistence wages. In 1989, per capita income was approximately $6,000.[4] As a result, many of the light consumer goods that were the foundation of Hong Kong's economy -- textiles, clothing, basic electronics, toys, watches and clocks -- are coming under increased competition from developing Asian countries with cheaper labor.

Responding to Changes

Hong Kong's manufacturers are responding to these developments in a number of ways. Some are automating; others are moving into more complex product lines, like liquid crystal displays, microcomputers and sophisticated telecommunications. Many are transferring their production to cheaper areas -- most notably China.

Relationship to U.S. and California Economy

Notwithstanding these major changes in its fundamental economic structure, the importance of Hong Kong to the U.S. and California cannot be overestimated. Current statistics indicate that Hong Kong is now the 10th largest market for U.S. goods and the U.S. is Hong Kong's principal trading partner after China.

Due to limited natural resources, Hong Kong is dependent on imports for virtually all of its requirements including food and other consumer goods, raw materials, capital goods, fuels and even water. In February of this year the U.S. ran a $45.9 million surplus with Hong Kong, spurred by a 27% increase in American exports. In 1989, Hong Kong sold to America goods worth $9.25 billion and bought U.S. products valued at $5.92 billion.[5]

Latest California statistics indicate that Hong Kong bought nearly $1.2 billion worth of California goods, making it the state's 10th largest export market.[6] More impressive are the prospects for still more exports including California agricultural commodities which are in high demand. This will be discussed in more detail in the section on "Best Export Prospects."

A few other facts are worth noting at this point. With a population of just 5.8 million, Hong Kong imported more on a per capita basis than any other country in Asia, or about $700 in U.S. goods per person. That is three times the level of Japan's consumption.[7]

On the investment side, American investment although slowing recently is nonetheless expected to rebound. At the end of 1989 there were some 900 U.S. firms doing business in Hong Kong, including 20 licensed banks. Of the 100 premier banks in the world, 76 had operations in Hong Kong.[8] The most recent significant development regarding banking from a California perspective was the movement by Bank of America of its Asian headquarters to Hong Kong. That action, according to the bank's senior vice president, was made for logistical and cost-effective reasons.

The Political Situation and the Labor Shortage

If this report had been written immediately after the ACA visit to Hong Kong last year, it would have been a much different report. Although the ACA is still generally optimistic about the long-term economic vitality of the territory and opportunities for California's international business community, there are legitimate concerns resulting from the Tiananman Square incident. That event has compounded worries over the transfer of Hong Kong from British to Chinese control in 1997 and has exacerbated uncertainties not only for the people of the territory but also for the foreign investor.

One of the most glaring results of this lack of confidence is the increased exodus of workers, particularly those with much needed technical and professional expertise. Hong Kong officials admit that the "brain drain" is real. More than 1,000 people a week are now emigrating from Hong Kong, primarily to Australia, Canada and the United States. On the last day to apply for British naturalization, more than 18,000 heads of household had applied. Giving legal assurances that they would be able to secure a valid British passport as an insurance policy was thought by the British to be one way of stemming the exodus of skilled workers. The British Government in effect held out the promise of an escape hatch after 1997 for approximately 50,000 Hong Kong families.

As Hong Kong's industrial and service sectors continue to mature, relying more and more on a technically proficient and well-educated workforce, its future economic stability may very well depend on just how it learns to cope with this flight. One way that the Hong Kong government appears to be coping with this growing problem is by allowing foreigners who have special skills or expertise entry into the labor market of the territory. In 1989 alone approximately 11,500 people from 30 countries were admitted for employment.[9]

It remains to be seen whether the emigration pattern will slowly subside and real confidence return. Much will depend on the action of the government in Beijing. Hong Kong's citizens have expressed their uneasiness by demonstrating for stronger guarantees for democratic rights after 1997, and the PRC has made guarantees to Hong Kong that it will be able to keep its capitalistic system for at least 50 years. In the past Beijing has generally taken a pragmatic stance, recognizing that the prosperity of Hong Kong is in its own best interest. Hong Kong currently accounts for 35% of China's foreign exchange and 60% of its foreign investment.[10]

The future of Hong Kong will also rest on whether the people of Hong Kong will regain their belief in "one country and two systems concept." On the positive side, they have always demonstrated an amazing resilience and fortitude in the face of adversity. Similarly the business community appears guardedly optimistic and active. Hong Kong is still for many companies the best place in Asia to establish regional headquarters and conduct Asian business.

TRADE BARRIERS

However businesses from the United States and California end up dealing with the Hong Kong market, their decisions are unlikely to be affected by territorial trade barriers. Unlike Asia's other newly industrialized countries, Hong Kong did not deny foreign businesses access to its market while achieving its dramatic growth and prosperity.

The government's policy is to interfere with the economy as little as possible. In the trade of goods, there are no import tariffs. There are duties on some items, but they are levied for revenue purposes only and are applied equally to foreign and domestic products. Similarly, the government makes no distinction between foreign and domestic ownership, nor are there any restrictions on the conversion or remittance of profits. Hong Kong is also extremely liberal in its monetary policy. It does not control the money supply and has no central bank. Hong Kong's single major intrusion in the economy is to maintain the value of its currency at 7.8 to 1 against the U.S. dollar.

The only significant uncertainty in Hong Kong's restrictions on foreign commerce involves copyright protection where there had been serious instances of infringement. However copyright protection in Hong Kong is now strong, with foreign works being protected provided ownership is vested in a country which is a signatory to one of the international conventions. The American Chamber of Commerce in Hong Kong, in reviewing Hong Kong's intellectual property laws, noted for the Advisory Council that they were among the strongest in the world.

HONG KONG AND CHINA

The recent flurry of concern by the Hong Kong government and its business community over U.S. extension of China's "Most favored Nation" (MFN) status clearly indicates the growing economic relationship between the territory and the PRC. Many assume that the business relationship Hong Kong and the mainland will establish will not move forward substantially until China regains sovereignty in 1997. In fact, this relationship is being developed right now. The two have already begun integrating their economies in areas ranging from trade to investment to training to tourism. In 1978 Hong Kong did $1.4 billion in business with China. Eleven years later the figure had grown to $43 billion, making China its leading trading partner.[11] Obviously, there really is no turning back.

That integration is exemplified dramatically in the relationship between Hong Kong and neighboring Guangdong province in the People's Republic. With wages far lower on the mainland, an increasingly greater share of Hong Kong's labor-intensive manufacturing production is moving to Guangdong. In 1988, for example, Hong Kong's exports of electronics products increased 32%. A major reason, according to Andrew Chan, chairman of the Hong Kong Trade Development Council's sub-committee on electronics, was the China manufacturing link which provided Hong Kong's manufacturers a price advantage over Taiwan or Korea. Today about 2 million workers in Guangdong province are employed in Hong Kong-owned factories.[12] Most economic observers expect this integration to continue and intensify.

The Hong Kong Trade Development Council sees a future in which the Hong Kong economy will center around a handful of limited and increasingly sophisticated sectors. These would include research and development, marketing, financial services, and the manufacturing of products that are either highly sophisticated or -- like garments -- subject to quotas limiting their import from low-cost areas. Under this scenario, factories in China would take over the bulk of the labor-intensive assembly work.

The Hong Kong-Guangdong link is not the only area in which the increasingly intimate relationship with China is manifesting itself. Huge numbers of mainland companies are setting up operations in Hong Kong. In 1976, there were only about a dozen such companies. Today, there are an estimated 2,000 PRC companies in Hong Kong. The U.S. Commerce Department notes that "there is not a single major commercial initiative in Hong Kong today from which PRC interests are excluded."[13]

The commerce those firms generate is reflected in the massive growth of Hong Kong's "re-export" market, through which Hong Kong exports goods that are manufactured in China. Hong Kong has long been an important distribution center for trade in Asia and the Pacific. Now that activity has exploded, growing 20% annually in the last decade -- from $2.8 billion in 1978 to $44.6 billion in 1989.[14] Increased trade with China has been the major reason for this growth. China is both Hong Kong's leading re-export market ($13.2 billion) as well as its main supplier of imports ($25.2 billion).[15]

This growing relationship between Hong Kong and China has broader significance. For foreign investors -- which already include large numbers of firms from California -- Hong Kong is becoming a steppingstone for doing business on the mainland. As one economic official told the Advisory Council, Hong Kong provides a cultural training ground for doing business in China.

In one little-publicized, but fast-growing area, Hong Kong is already serving as a bridge to investment in China. Increasingly, it is providing the link between Taiwan and the mainland. The PRC, of course, remains an emotional subject on Taiwan. The two nations have no official government relations even though growing numbers of tourists and business people have been traveling to China in recent years.

This lack of formal government relations has not hampered business between the two. In fact, it is booming with Hong Kong acting as the go-between in many instances. Zheng Hongye, the acting chairman of the China Council for the Promotion of International Trade, told the "PacRim 89" conference in Hong Kong that the People's Republic has become Taiwan's fourth largest trading partner in Asia. The Hong Kong Trader put the value of that trade at $3.7 billion in 1989. During that year it reported that entrepreneurs from Taiwan invested more than $400 million on nearly 300 projects, outstripping the investments of both the United States and Japan. The relationship is now so substantial that the Chinese government has issued formal regulations on Taiwan's trade and investment with the mainland.

BEST EXPORT PROSPECTS IN HONG KONG

Opportunities in Hong Kong today are very real in spite of its current sluggish economy and an increase in the Consumer Price Index of about 10% over last year. Improvements in its public services, the increasing sophistication of its manufacturing and service sectors and intensive construction activity in the public sector hold out the promise of improved sales for California exporters. The following, according to Commerce Department analysts, are the best prospects.

<u>Food and Agricultural Commodities</u>: Hong Kong is almost totally dependent on foreign nations for its food, and California and the U.S. fill a substantial portion of that demand. According to the U.S. Commerce Department, Hong Kong purchased $221 million in fruits, vegetables and meat products from the United States in 1988 and that figure is growing. Export figures suggest that nearly half of that originated in California. As one might expect, the state government, and its agricultural marketing boards, are felt by economic analysts to be doing a good job of selling into the Hong Kong market. But unrealized opportunities remain. Convenient, high-quality grocery items are felt to have good prospects. Fruits, vegetables, poultry, eggs, meat and meat products, ginseng, tobacco, wheat, fur skins, wine and beer also are in demand.

<u>Health Care</u>: The Hong Kong government plans to build four major hospitals in the next decade. Since there is a limited domestic hospital equipment industry, this creates an excellent opportunity for U.S. manufacturers, a number of which are located in California. According to the Commerce Department, U.S. firms held approximately 30% of an estimated $160 million market. With demand expected to grow 17% annually in the next few years, and with U.S. products enjoying a good reputation for reliability and technical support, prospects for increasing sales appear strong. The Commerce analysis contends that the best prospects are: cardiological, neurological, ophthalmological and renal equipment; operating room aids; pediatric and obstetric products; rehabilitation aids; sophisticated monitoring, diagnostic and research technology; and general hospital implements.

<u>Textile Fabrics</u>: Hong Kong is one of the world's largest importers of textile raw materials. Textile fabrics make up 60% of this $10 billion market. Yet according to the Commerce Department analysis, the U.S. supplies less than 1% of these fabrics. The reason the market share is so modest, according to analysts in Hong Kong, is that U.S. manufacturers are not willing to supply the small, quick orders Hong Kong firms want. If the U.S. firms would be willing to adjust, the analysts generally feel the market could be penetrated, particularly in view of the drop in the value of the dollar. While this is not a major

industry in California, the state's textile firms do export around the world and would be wise to take a new look at Hong Kong.

<u>Computer Equipment and Software</u>: As the world's third largest financial center, Hong Kong offers a significant market for computer equipment and specialized software. This is, of course, an obvious California strength, with many of the leading exporters based in the state. The users of these products include banks, insurance companies, and money, stock, and commodity brokers. In addition, Hong Kong's government departments and utilities are potential markets. Selling in these markets will require both reliable and accurate equipment, and efficient after-sales service.

<u>Industrial Packaging Equipment and Materials</u>: With the light industrial sector having to deal with an increasingly tight labor market, there is a growing need for products that will assume packaging, wrapping and shipping functions. Commerce Department analysts contend that wrapping, packing, labeling and stamping machinery will all find markets among Hong Kong's manufacturers. As in so many other areas, the successful exporter will be able to back up their sales with service and spare parts.

<u>Office Equipment and Furniture</u>: The Commerce Department reports that this market is also expanding. This is the result of both the growing Hong Kong service sector, and the increasing number of firms that have based their regional and PC operations in Hong Kong. While Japanese products dominate the market and U.S. manufacturers have a minuscule share, American products could be much more competitive. The equipment in this category includes electric and non-electric typewriters, photocopiers, check-writing machines, adding machines, calculators, and cash registers.

<u>Pollution Control</u>: As Hong Kong grows more affluent, it has begun to focus greater attention on improving the environment. There is little doubt that the dynamic expansion of Hong Kong's port and manufacturing industries has had a deleterious effect on the environment. There are now serious problems related to air, water and noise pollution, asbestos in buildings, sewage and trash disposal. Solving these problems may result in expanded business opportunities for California firms. While this state does not have a large share of the manufacturers of pollution control equipment, its strict laws have caused substantial numbers of environmental engineering/consulting firms to set up offices here. These firms could provide much needed technical and consulting services in Hong Kong as it begins to grapple with its own environmental problem.

In addition, the industrialization of mainland China is likely to create environmental problems that will eventually have to be resolved. Addressing those problems in the Chinese market of Hong Kong can lay the groundwork for similar work on the mainland.

<u>Consumer Goods and Franchising</u>: With a young and increasingly affluent population, and a large tourism industry, Hong Kong's consumer demand for everything from innovative food products to high fashion is rising. One particularly promising area is franchising. Commerce feels the best prospects for U.S. franchises are in upscale retail merchandising, restaurants, and fast-food outlets. There are also opportunities in the service sector, including car rental companies, dry cleaners, courier services, computer-training services and convenience stores.

THE INVESTMENT CLIMATE

A variety of factors make Hong Kong attractive to the foreign investor. Among its advantages are: a well-developed infrastructure, educated workforce, stable government, efficient civil service, English-speaking business environment, and close link to markets in China. On the downside it must be noted that while Hong Kong's labor force is both highly productive and reliable, it is now the third-highest-paid in Asia, trailing only Japan and Taiwan.

Hong Kong also has the most open investment market in the developed world. The government makes no distinction between local and foreign companies, has no controls on foreign exchange, and has the lowest corporate profits tax -- 16.5% -- in Asia.[16] It is one of the best examples of a free enterprise, market-driven system at work. These characteristics have attracted investment from all over the world and account for the infusion of between $6-7 billion from the United States alone. Until recently the U.S. was the single largest investor in Hong Kong.[17]

The United States is still the leading investor in the manufacturing sector, with activity accelerating significantly during the 1980s. Currently, United States companies have approximately $1 billion invested, spread over 162 identified firms, with the electronics sector receiving the largest amounts, followed by textiles, clothing, chemical products, and toys.[18]

The volatile real estate market which attracts much foreign investment was particularly hard hit by events in China last year. Prior to June 1989, demand for most property was strong. One local business leader told the Advisory Council during its visit early in 1989 that whereas prior to 1983 approximately 90% of investment-grade properties were in the hands of local Hong Kong citizens, the figure is now in the neighborhood of 70%. This fact contributed to the spiraling price increases and huge returns on investment that were evidenced in the real estate market prior to June 1989.

Events in China have had their effect on this sector. Since June 1989 transactions have decreased and prices have fallen an average 15-20%. Investors have become more cautious and selective. This cautiousness is seen in the luxury condominium market. Many potential buyers have decided to rent or lease -- at least until they see how things play out after 1997.

Not everyone, however, is holding back on investing. The desire of many Japanese companies to participate in Hong Kong's seaport and airport development projects and to expand their retail operations in the territory will make the Japanese the largest foreign investors in Hong Kong for 1990. In 1989 the Japanese invested $2 billion in the territory for a cumulative total of $8 billion.[19]

Ultimately, Hong Kong's open door investment policy and ability to attract foreign investment will hinge on how well China adheres to its commitment to allow the territory to maintain its open economic system. As one business leader pointed out to the Advisory Council, Hong Kong will demonstrate whether China is capable of living up to its "one-country-two systems" pledge.

The Chinese connection is also a matter of enormous potential. The People's Republic is still a very poor country. But with the world's largest population, a rich cultural history, and the natural entrepreneurial gifts of the Chinese, its potential is limitless. Hong Kong could be an important bridge for the future U.S. investor. Many companies from California and the United States would like to begin carving out a niche in that market. One such company, Western Digital Corporation, a California-based multinational and a leading semi-conductor and computer products manufacturer is already taking advantage of these market opportunities. It launched a sales operation in Hong Kong last year. The market for its products, the low tax rate and proximity to China were all important considerations.

HONG KONG'S INVESTMENT IN CALIFORNIA

As might be expected from its uniquely open economic environment, Hong Kong puts no restriction on the foreign investments of its business people. As a result, Hong Kong's investment in this country is substantial and growing. Moreover, the anxiety over 1997 has prodded many of Hong Kong's business people to look for safer havens for their money. It is likely that the United States, and California in particular, will attract a significant share of that money.

We do know from the Bureau of Economic Analysis of the Department of Commerce that there has been a $250 million increase in capital inflows into the United States between 1988 and 1989, bringing the cumulative position of foreign direct investment of Hong Kong investors for 1989 to $1.2 billion. It also estimates the value of assets controlled by Hong Kong investors in the United States at $9.2 billion (1988), while gross book value of property, plants and equipment is estimated at $2.2 billion.[20]

Although Hong Kong does not currently rank among the largest of California investors it is infusing more capital here according to officials at the Bureau and the California Department of Commerce -- the state agency which promotes California to foreign investors. It noted a threefold increase between 1980 and 1987 in gross book value of California property, plant and equipment owned by Hong Kong investors, rising from $244 million to $910 million.[21] It is doubtless higher today. The strong cultural links to the large Chinese communities of California also act as a magnate for Hong Kong investors.

A number of members of Congress feel the federal government is doing a very poor job of collecting information about foreign investment in the United States. They are supporting various proposals to allow for the compilation of additional information including legislation to require any foreigner who purchases a 5% interest in business or real estate worth more than $5 million to report to the Department of Commerce.

Some countries have linked investment and immigration. For example, Canada is now a major destination of Hong Kong emigres since it eased its immigration rules allowing those with $500,000 net worth and capital to invest an opportunity to settle there legally.

NEW OPPORTUNITIES FOR CALIFORNIA INTERESTS

Notwithstanding all the uncertainties, opportunities for U.S. and particularly for California-based companies are still promising. Plans for a variety of major development projects focusing on basic infrastructure and the environment offer exceptional business prospects. Among the important new projects being planned are the following:

- New airport complex at Chek Lap Kok, Lantau ($16 billion)
- A seventh container terminal ($7.5 billion)
- A third university ($250 million)
- Two new hospitals ($513 million)
- Environmental Protection Plan ($385 million)
- New urban parks, cultural centers and museums ($256 million)
- A new tunnel under the mountains to the New Territories ($250 million)
- A cable TV system ($700 million)
- Sewage system overhaul, landfills and refuse transfer stations ($2.5 billion)

Among these, the airport and seaport projects offer exceptional opportunities for the world-wide construction industry and related business sectors. The airport project and the rail links associated with it should be complete by 1997 and will be the largest project ever undertaken in Hong Kong. Together with the seaport expansion project, Hong Kong expects to spend $16.2 billion through 2006. Already more than 700 firms have shown interest in participating in these projects.[22]

With regard to the new Chek Lap Kok Airport, Bechtel Inc., headquartered in San Francisco, has been awarded the project management contract for the new airport. The value of that contract is estimated at $11.5 million. In addition Greiner Airport Consortium, which includes an American firm was awarded another contract estimated to be worth $25 million. A joint venture between Parson Corporation of Pasadena, California and Brinckerhoff Quade & Douglas of New York was included in a consortium chosen to undertake a $2 million feasibility study for the rail link to the new airport.[23]

DOING BUSINESS IN HONG KONG

Hong Kong is one place in the world where it is impossible for foreign businesses to blame whatever problems they are having on local barriers. If you fail to reach your full potential in the world's most open market, the fault is likely to be your own. And while businesses from California and the United States, in general, have enjoyed more success than failure in Hong Kong, they could do even better.

Improving that performance will likely depend on a single variable -- determination to succeed. It will involve the willingness to establish and nurture personal relationships with customers and clients. It also means understanding the intricacies of international business and mastering the rules.

Sensitivity to the special needs of the market matters. One Hong Kong official, for example, told the Advisory Council that there is good potential for U.S. car sales in Hong Kong if manufacturers would produce vehicles with right-hand drives. He pointed out that a food manufacturer had recently marketed its product in a green carton, not knowing that it was considered unlucky and would put off customers. A U.S. commercial officer offered yet another example. Hong Kong is a huge fabric market, but local companies end up buying from Japan or China because U.S. firms are not geared up to produce the quick and relatively small orders that are wanted. Finally, once products are purchased, after-sales service becomes paramount. To provide this service, some firms warehouse products in Hong Kong or have local production facilities.

None of these practices are revolutionary. Nonetheless, attention to them will often mean the difference between success and failure in the Hong Kong market.

TAIWAN'S CHANGING ECONOMY
An Assessment

For the last 20 years Taiwan's export-driven economy has been characterized by cheap labor, protectionist trade barriers and growing trade surpluses with the United States. Finally, real change is taking place within its economic structure and attitudes toward two-way trade. The end of marshall law and other recent political and social reforms in Taiwan have accelerated these changes and created an atmosphere all the more conducive to expanded commercial relations between California and Taiwan.

A Restructured Economy

Taiwan's transformation into one of the world's most dynamic economies is the product of policies which moved the island away from agriculture and toward industrialization and a reliance on foreign trade to fuel its economic miracle. With an unemployment rate of less than 2% and a per capita GNP of $7,509 in 1989, Taiwan deserves much of the praise it has received.[24] Today it ranks as the 13th largest trading nation, the U.S.'s 9th largest export market, and California's 8th largest export market.[25] These facts are all the more remarkable considering that 40 years ago trade accounted for only 9.7% of Taiwan's GNP. By 1988 the figure had risen to 50.7% of GNP. Taiwan's total two-way trade with the United States approaches $36 billion.[26] Equally impressive is its trade with California valued at $9 billion.[27]

More recently changing national priorities are now restructuring the economy in several important ways, most notably away from labor-intensive, low-technology industries -- footwear, garments, toys and sporting goods -- to more automated, high-technology products. In addition the government's resolve to reduce its bloated trade surplus with the United States and to relax numerous trade barriers is having a major impact on the economy. Just as important is the new emphasis placed on expanding domestic demand to support economic development rather than reliance on exports alone.

A new factor in the equation is the growing awareness by the general public and government officials that quality of life is as important as economic development. After years of neglect in order to accommodate rapid industrialization, the environment is finally receiving attention. Public pressure has forced the government to direct substantial amounts of money to facilitate major improvements in basic infrastructure and to reduce air and industrial pollution. Many public leaders now regard traffic and the pollution it generates to be the number one problem in Taipei and are seeking a balance between economic growth and a healthier environment. To illustrate the severity of the problem, by June

1989 approximately 435,000 cars and 570,000 motorcycles and scooters were converging on Taipei's already overcrowded streets. The situation is further exacerbated by an additional 5,147 cars which enter Taipei traffic each month.[28] Clogged roads and unhealthy air are now the norms for this city of 2.7 million inhabitants.

The Trade Gap

The commitment to reduce its blotted trade surplus with the United States is the cornerstone of Taiwan's economic relationship with the United States. By any standards that surplus has been unacceptable. In February 1989, the chairman of the Council for Economic Planning and Development, announced that Taiwan planned to slash its trade surplus with the United States by 10% a year for the next five years.

Even before this announcement the Taiwan government had begun to take steps to reduce the surplus. The deficit was reduced from $17.4 billion in 1987 to $10.4 billion in 1988. The figure rose to $12 billion in 1989, but if gold imports for 1988 and 1989 are disregarded, the 1989 surplus is 9.8% less than in 1988 and very near the Taiwan target goal of a 10% annual reduction in the deficit.[29] It should also be kept in mind that according to estimates by Taiwan's government, approximately 11% of that imbalance is generated by American corporations that manufacture at plants in Taiwan then ship the products back for sale in the United States.

The significant start Taiwan made toward that goal did not happen by accident. Taiwan had been pressured by the U.S. government to appreciate its currency substantially. That action was taken and the currency appreciated approximately 41.5% against the U.S. dollar since 1985.[30]

Trade officials have told the Advisory Council that the long-term goal is to eliminate the surplus entirely. Taiwan stands alone among Asia's Newly Industrialized Countries (NICs) in taking serious steps to pursue that goal. According to officials interviewed by the Advisory Council, probably the most compelling reason for this policy change is the recognition that the trade surplus and the protectionist barriers that played a role in generating it were creating serious tensions with the United States -- its most important trading partner.

Buy American

The strategy to reduce the trade surplus is supported by Taiwan's "Buy American" policy which encouraging both public and private enterprises to increase their purchases from the United States. In the last 12 years a total of 16 "Buy American" missions have resulted in the purchase of $12 billion worth of U.S. products ranging from agricultural commodities like soybeans, cotton and concentrated juice to industrial products including airplanes, electrical power equipment, buses, computers and other consumer goods.[31]

More Sophisticated Technologies and an Increased Standard of Living

The move from low- to high-tech is the inevitable result of Taiwan's economic success. With a 15% rise in labor costs from 1985-88, Taiwan is hard pressed to maintain its image as a haven for inexpensive products and cheap-labor.[32] Its wages are now second only to Japan among Asian countries. As a result, more and more of Taiwan's labor-intensive manufacturers in industries like textiles and low-cost footwear have been transferring their production to Asian nations like Thailand and Sri Lanka where wages are much lower. In this respect it follows the example of Hong Kong which has transferred much of its labor-intensive work to the PRC.

This has not, however, created significant dislocations in Taiwan. As old industries have started moving elsewhere, new ones are being nurtured to take their place. Nor has it reduced prospects for California businesses. With living standards and concern with quality of life issues increasing, opportunities for exports in areas ranging from consumer goods to medical care to environmental protection are growing. Taiwan's move into high-tech, energy-efficient industries like sophisticated electronics, computers, telecommunications, and machine tools also creates new opportunities. It generates demand for advanced electronics components, industrial process controls and sophisticated scientific instruments for research and development.

A Springboard to Asian Markets

The Advisory Council has come to believe that there is major potential for California businesses in forming partnerships and joint ventures with their counterparts on Taiwan. The goal would not be, as in the past, to simply sell back to the U.S. market, but rather to create a mutually beneficial "springboard" to markets throughout Asia where Taiwan's trade already accounts for 15% of its total foreign trade. California businesses would supply the sophisticated manufacturing technology Taiwan currently lacks. Taiwan would supply the experience, marketing savvy, and permanent physical presence that facilitates the sale of these products to its neighbors.

TRADE BARRIERS

The reduction in Taiwan's trade surplus is not just the result of the appreciation of its currency, and its "Buy American" campaign. It is also the result of a national effort to reduce trade barriers. According to the Board of Foreign Trade of the Ministry of Economic Affairs, Taiwan has reduced tariffs on 4,727 items between 1985 and 1987. It has cut the average effective duty, which reflects typical customs duties for imported goods, by nearly half -- from 14.1% 18 years ago, to just under 7%. To increase imports from nations with whom Taiwan runs trade surpluses, tariffs on an additional 3,523 items were cut by an average of 50% in 1988. The items affected included a wide range of agricultural, chemical, wood, paper, and consumer products. Additional reductions are being phased-in.

The Taiwan government has initiated other actions aimed at increasing two-way trade, including the following:

-- subsidizing the office rent of U.S. state government trade promotion offices in Taipei

-- offering free exhibition space at special trade shows for American products

-- restricting bidding on some government projects to U.S. and European bidders

-- holding seminars to help trade representatives understand Taiwanese bidding procedures

--providing export financing through Taiwan Export-Import bank at competitive rates to U.S. firms selling capital equipment and industrial inputs. (These funds are available through correspondent U.S. banks for up to $2 million per transaction.)

The U.S. State Department acknowledged this liberalization in a report it submitted last year to Congress. Still, problem areas remain as documented by the State Department. It contends that tariffs are still excessive and remain especially high on a number of agricultural and fishery products, some of which are barred altogether. In addition, the State Department asserts that the importation of a number of agricultural and industrial products continue to be hindered by excessively strict permit provisions, customs procedures, or inspection requirements.[33]

Intellectual Property Rights

One of the most critical areas for California high-technology firms is intellectual property rights. U.S. officials acknowledge significant improvement from the notoriously lax environment that existed in the past, but contend that problems still remained in a number of areas, including computer software, videotapes, and semiconductors.

Films are a particularly sore spot, with the U.S. industry claiming that its earnings in Taiwan were cut by as much as 50% by the emergence of large numbers of establishments showing videotapes of motion pictures without compensation.[34] These "MTVs" or mini theaters have come under increased scrutiny by the Taiwan government since May 1989. This action and other policy decisions by the Taiwan government demonstrate a trend toward trade liberalization which can only benefit California-based exporters.

The 1990 National Trade Estimate Report on Foreign Trade barriers by the Office of the United States Trade Representatives indicates that considerable progress has been made on a number of fronts to make Taiwan more open to California products and services. But it also clearly indicates that a number of barriers remain which restrict the free flow of trade.

Agricultural Commodities

High tariffs on agricultural products are particularly troublesome. Fresh fruit and processed agricultural products often face import duties of up to 40-50% *ad valorem*.[35] For California agricultural interests the reduction or elimination of tariffs on agricultural imports could create significant export opportunities where we have a comparative advantage. Fresh fruit exports including apples, pears, avocados, citrus and kiwifruit could rise about $6 million a year, while fruits juices and drinks could add another $3 million. Nuts and dried fruit sales could also increase by $8 million annually as a result of tariff reductions. [36]

A reduction in tariffs will not by itself open new markets for California products. Savings will have to be passed on to consumers. However, in many instances consumers have failed to recognize any savings as a result of tariff reductions due to an archaic distribution system. Often suppliers and small retail operations are unwilling to pass on price reductions to their customers. Many of these problems are similar to those faced by U.S. exporters trying to penetrate the Japanese market.

Taiwan's import licensing system also poses additional burdens on California agriculture. The relaxation or abolition of import licensing on rice alone could increase California rice exports by $8 million.[37]

BEST EXPORT PROSPECTS IN TAIWAN

Notwithstanding lingering problems related to high tariffs and other barriers to trade, opportunities in Taiwan today are very real and growing. The restructuring of Taiwan's industrial base, the expansion of its infrastructure, the growth of its consumer economy, and its genuine desire to increase imports from the United States, all contribute to a better trade climate and improved sales for California exporters. Boosting prospects even more, according to the U.S. Commerce Department publication, "Marketing in Taiwan," is that American products enjoy good reputations for quality and technical superiority in Taiwan. What tends to hurt U.S. exporters, according to Commerce, is the time it takes to deliver products and the availability of after-sales service. Improving performance in these areas, and marketing aggressively, will allow our firms to take advantage of very real export opportunities.

The following section describes the areas the Commerce Department identified as having the best export prospects and includes a brief analysis of the extent of California's involvement in them.

Process Controls: The promotion by Taiwan's government of industrial automation, combined with its "Buy American" campaign, have made this a very promising market for U.S. firms. Although Taiwan's private firms make most of their purchases from Japanese manufacturers, the Commerce Department study says the public sector is expected to meet most of its needs here in the U.S. for the steel, petroleum and petrochemical industries. In addition, the Commerce Department predicts there will be rapid growth in industrial process controls, electronic instruments, process control computers, and peripherals. The rubber, plastics, and primary metals industries are expected to be strong markets for these products.

Electronics: The growing sophistication and rising labor costs of Taiwan's electronics industry are leading to a shift toward increased use of advanced components, automated production and test equipment. According to the Commerce Department study, 80% of current need in these areas is filled by imports. The market is expected to expand 25% annually through 1993, and the U.S. and Japan will be the main competitors for this business. The best U.S. export prospects are automatic production systems, sophisticated controlling and testing instruments and advanced components.

Information Processing: Computers are increasingly utilized in Taiwan. According to the Commerce Department study, $660 million was spent on computers and peripherals in Taiwan in 1987, with demand expected to increase by 25% annually through 1992. The United States dominates this market, with 58% of current imports, and is expected to be able to keep that figure above 50% through 1992. This, of course, is an obvious California strength, with many of the leading exporters being based in the state. It should be kept in mind that the Commerce study also points out that the challenge posed by the Japanese will be enhanced by both the low cost of their products and their ability to work with Chinese ideographic characters.

Analytical and Scientific Instruments: The push for a more technologically sophisticated industrial base is generating increased activity in research and development. That, in turn, is creating increased demand for analytical and scientific instruments. According to the Commerce study, demand is projected to grow 15% annually, with the U.S. and Japan expected to dominate the market. Currently, U.S. suppliers are considered preeminent in high-cost, high-accuracy instruments. The Japanese have the edge in low-cost, less-advanced instruments. Commerce feels there is excellent sales potential in a number of areas, including bio-engineering and microprocessor control instruments, spectrum and network analyzers; testing instruments for aerospace and national defense; and hospital automation instrumentation.

Communications: Commerce believes this is a dynamic and growing market. Telecommunications services have increased sharply in recent years; telephone facilities are expected to grow 30% annually; digital transmission networks and switching systems will also expand.

Health Care: Taiwan instituted a 15-year national health care plan in 1985. Its main goal is to add new facilities to existing hospitals and clinics. Commerce reported that imports fill nearly 90% of Taiwan's medical equipment needs, that the market is evenly divided between U.S. and Japanese firms, and that Taiwan's publicly funded hospitals tend to buy their equipment from U.S. firms. As a result, prospects for U.S. products are considered very good -- particularly operating room, cardiology and clinical laboratory equipment. California has a large number of manufacturers of health care equipment, and should be able to do well in this market. It should be kept in mind that to sell to Taiwan's public hospitals, foreign firms must hire a Taiwan agent to represent them before the government procurement office.

Energy: Taiwan is dependent on foreign suppliers for energy, energy-conservation equipment and renewable energy technology. Currently, the U.S. and Japan supply the bulk of this equipment and technology. The best opportunities for U.S. sales are likely to come from combustion control equipment; equipment to conserve steam and waste heat; systems to recover waste water; and products that can generate renewable energy along the lines of solar cells, collectors and wind turbines.

__Transportation__: Taiwan has initiated a number of major transportation projects to deal with the sharp increase in vehicular registration and road congestion. These include the Taipei Rapid Transit Project, costing $15 billion and slated for completion in 1999.

__Consumer Goods__: With personal income rising and export barriers falling, the market for consumer goods is expected to be robust. Home appliances are particularly popular, with U.S. products considered very desirable in a number of areas, including refrigerators and washing machines. The market for air conditioners and home electronics is also strong. The demand for food, wine, cigarettes, medicine, and pharmaceutical, many of which are manufactured, grown or processed in California, is likewise expanding.

__Pollution Control/Environmental Trade__: Special opportunities exists in Taiwan for California's highly sophisticated and renowned environmental consulting firms and related industries. Taiwan's dramatic economic growth during the past three decades has taken place at the expense of the environment. Now Taiwan is facing up to years of environmental neglect.

The public's concern about the issue has led to Taiwan's Environmental Protection Agency being elevated to Cabinet-level status. Between now and the year 2000 the government is expected to appropriate $33.3 billion on environmental protection projects. U.S. pollution-control equipment manufacturers rank second behind Japan among Taiwan's suppliers and hold a 30% share of the overall market. U.S. market share should grow dramatically in the next several years. Additionally, U.S. equipment is expected to have very good prospects in the air pollution, nonhazardous waste, and noise control instrumentation markets. Among the major projects being planned is an island-wide pollution-monitoring system for air, river and ocean pollution.

While California does not have a large share of the manufacturers of pollution-control equipment, its strict laws have caused substantial numbers of environmental engineering firms to set up offices here. The opportunities for these firms are extensive. In addition, the industrialization of mainland China is likely to create environmental problems that will eventually have to be addressed. Laying the groundwork in Taiwan could prove advantageous in the long run.

THE ASIA CONNECTION

As was pointed out earlier, internal developments in Taiwan are not the only reason California businesses should take a new look at opportunities there. They should also examine the possibility of using Taiwan as a "springboard" to Asian markets the U.S. has not been very successful in penetrating.

Clearly, market penetration problems are not entirely the fault of American businesses. Asian nations have often made it a policy to discourage U.S. exports with a range of trade barriers. Beyond that, however, the success of American businesses in Asia has been hindered by cultural dissimilarities and differences in business practices and by the unwillingness to spend the considerable amount of time abroad that sales often require.

With their greater physical and cultural proximity to their Asian neighbors, Taiwan's business people can overcome those hurdles much more easily. In fact, they already are. Taiwan's exports to other Asian nations more than doubled between 1984 and 1988. Its exports to Japan increased 150%. Taiwan's exports to Asia totaled approximately $18 billion in 1988; its exports to Japan alone totaled $8.4 billion. On a per-capita basis, Taiwan outdoes the United States in exporting to Asia. It exports twice as much to Asia, and three times more to Japan alone. Today its foreign trade with the rest of Asia accounts for 15% of its total trade.[38]

The decision of the Taiwanese government to convert three export processing zones into free trade zones before 1997 is significant and lends greater credibility to Taiwan's claim as a second entry door for trade with the rest of Asia and in particular the Association of Southeast Asian Nations (ASEAN).[39]

All of this suggests some very interesting possibilities. By creating joint ventures with businesses in Taiwan, or licensing technology to them, California firms might achieve levels of sales in Asia -- including Japan -- it would never otherwise be able to attain.

TAIWAN AND MAINLAND CHINA

Although no formal government relations exist between mainland China and Taiwan travel and trade between the two has been growing dramatically in the last three years. Much of this by necessity takes place indirectly through paper companies in third countries and the territory of Hong Kong where there are already representative offices of 100 Taiwanese companies.

Zheng Hongye, the acting chairman of the China Council for the Promotion of International Trade at the "PacRim 89" conference in Hong Kong noted for the Advisory Council that the People's Republic has become Taiwan's fourth largest trading partner in Asia. Two-way trade through Hong Kong is growing at a 45% annual rate and in 1989 reached $3.7 billion. During the year, entrepreneurs from Taiwan invested more than $400 million on nearly 300 projects in China. In China's Fujian Province, Taiwan is already the largest industrial investor and Formosa Plastics of Taiwan has already announced plans to build a $7 billion chemical plant there.

In fact, the relationship is now so substantial that the mainland Chinese government has issued formal regulations governing Taiwan's trade and investment with the mainland. According to the China Economic News, the Chinese Ministry of Foreign Economic Relations and Trade has established the Department of Economic and Financial Relations with Taiwan to formulate economic and trade policies and manage imports and exports.

Clearly, problems remain as the China Economic News pointed out: "The economic and trade ties are still in the initial stages of development. They are not well channelled and cover a very limited range of fields; the size of investment and trade fall far short of each other's need and potential."[40] Beyond that, no one can predict the ultimate fate of the economic liberalization in the People's Republic. But two things seem clear. First, most specialists strongly believe it is extremely unlikely that China can afford to retreat from the market mechanisms it adopted in 1979, notwithstanding China's current political and social turmoil. Second, at least for the foreseeable future, it will not be easy for non-Chinese to deal with the obstacles the mainland bureaucracy puts in the way of foreigners. Building closer relationships with firms in Taiwan may make it easier for California businesses to overcome those obstacles.

THE INVESTMENT CLIMATE

Investment is the second opportunity Taiwan offers to California business and one that is opening up in a number of areas. For example, Taiwan has removed export performance and local content requirements in many industrial sectors. The implementation of additional liberalization measures in 1989 opened up to foreign investors all industries except agriculture, power generation, petroleum refinery, railroads, trucking, telecommunications and national defense. Today private investors are also being allowed to own banks in Taiwan. [41]

There is no doubt that foreign investment has been responsible for much of the economic transformation of Taiwan. Between 1952 and 1988, foreigners invested $8.5 billion in Taiwan, with the United States comprising the largest share -- approximately one-third of the total, and Japan a close second. In 1989 Americans invested $1.95 billion in Taiwan, a 16.8% increase over 1988. Currently the United States and Japan are jockeying for position as Taiwan's leading foreign investor for 1990.[42]

In the past overseas investors were attracted to Taiwan primarily for its low labor costs. Today with labor costs rising, investors are more interested in its highly trained technicians, strong industrial base and various government-supported incentives as inducements to investment. The vast bulk of that U.S. investment has been spent on plants that manufactured products to be exported back for sale in the United States. While that possibility remains open, the Advisory Council believes California businesses would be wise to look at investing in Taiwan as a way to create the "springboard" to the rest of Asia that was discussed earlier in this report.

Certainly, the government of Taiwan is eager to help foreign businesses build that springboard. As the foreign ownership figures listed above suggest, Taiwan has already created one wave of investment to help lift it from an underdeveloped country to "newly industrialized" status. It has done that by giving foreign investors some of the same incentives and privileges offered citizens of Taiwan. Among other provisions, this includes the right to own 100% of a particular enterprise; to remit all net profits and interest earnings; to repatriate all investment capital one year after operation commences; to be protected against government expropriation or requisition for 20 years if the foreign investment stays at 45% or above.[43]

Now Taiwan is seeking to attract a second wave of investment, which it hopes to ride to "developed nation" status. It is particularly interested in capital and technology-intensive enterprises, including sophisticated electronics, precision machine tools and specialty chemicals. To attract this kind of investment, the government has put together additional incentives. These include a five-year holiday on corporate income taxes; the right to defer the commencement of the tax holiday for up to four years; being able to charge research and development expenditures to operating costs. Duty exemptions and accelerated depreciation rates are also available in certain instances.

As a further incentive to attract high-technology business and highly trained scientists, technicians and engineers, Taiwan has constructed what it hopes will someday become its "Silicon Valley." The Hsinchu Science-Based Industrial Park located about 45 miles southwest of Taipei was built to attract sophisticated high-technology firms and accelerate Taiwan's development. Established in 1980 by the government it brings together academic and research institutions to develop new products and technologies in such diverse fields as electronics, computers and high precision machinery. By late 1989 there were approximately 100 firms operating in the park with an annual business approaching $1.5 billion.[44]

Firms locating in the Industrial Park are offered the most favorable tax terms, duty exemptions and other incentives including a reduction or exemption of land rentals for up to five years. These enterprises can also go to the government for venture capital up to 49% of total capitalization.

Many of the entrepreneurs establishing or working in these firms are Taiwanese who have lived abroad -- many in the United States and California. They are lured back home by opportunities and the growing recognition that Taiwan is fast becoming the world's fourth largest manufacturer of semiconductors.

Taiwan, of course, is not without flaws as a place to invest. A State Department analysis pointed out that a number of sectors -- notably agriculture, mining and electricity production -- remain completely closed to foreign investors. Severe restraints are put on foreign investment in services, as well. For example, the Taiwan insurance market is relatively closed. A maximum of two life and two nonlife U.S. insurance companies are allowed to enter the market each year through branch offices. However, branches of U.S. mutual insurance companies are not allowed to open in Taiwan. Similarly, foreign banks, the State Department pointed out, are essentially restricted to commercial banking.[45]

It is not agriculture, mining or electricity production that will provide American investors with a "springboard" into the rest of Asia, and ultimately into China. That will come from the kinds of technology and capital-intensive industries Taiwan is currently seeking to attract. In the course of our visit, several officials in Taiwan reflected on the impact that could result from firms in the U.S. and those in Taiwan joining together in enterprises that combined each other's strengths. The Taiwan firm could help American capital goods companies redesign products for the Asian market -- refrigerators were one example that came up. Then specialists in Taiwan could help with the marketing.

TAIWAN'S INVESTMENT IN CALIFORNIA

U.S. investment in Taiwan is, of course, much greater than Taiwan's investment here. While Taiwan's large trade surpluses have generated a foreign exchange reserve of $73 billion, it has traditionally been reluctant to invest those resources abroad. That began changing in 1984 when the government began promoting overseas investments and lifting the restrictions that inhibited them. In the last three years additional relaxation of government regulations has allowed individuals to take up to $5 million out of the country.[46]

Southern California, and in particular Monterey Park, has been the prime beneficiary of this wave of investment. With the largest concentration of Taiwanese in the United States it is the natural focal point for U.S.-Taiwan commercial relations. Although exact figures are difficult to come by, best estimates by Taiwanese government officials suggest that $1.5 billion has been invested in the area since 1985.[47] In reality much more is probably entering California indirectly. The Taiwan government's official estimate of overall overseas investment of $730 million may be as little as one-tenth the real amount going out of the country unofficially to avoid taxes.

Other states have also benefitted from this investment. For example, in Texas, Formosa Plastics intends to construct 28 petrochemical plants near Houston over the next five years at a cost of $3 billion.[48]

Banking is one sector where the Taiwan investment has noticeably increased and marks a departure in foreign investment strategy. By establishing a presence in the United States they can service the growing number of Taiwanese companies coming to the United States, and particularly to California. Omni Bank, headquartered in Monterey Park, has joined several other Taiwanese banks which have begun operations in California. Another example of this diversification in investment strategy is taking place in Northern California. To serve the approximately 100 Taiwanese companies operating in the Silicon Valley, Bank of Communications -- a major industrial development bank of Taiwan -- has opened a facility in San Jose.[49]

DOING BUSINESS IN TAIWAN

The United States is by far the largest market for Taiwan's exports. Mindful of this, the government of Taiwan is making special efforts to encourage the purchase of American goods. Still, the U.S. remains a distant second to Japan in exports to Taiwan.

The business and government officials with whom the Advisory Council on Asia met while in Taiwan said there were very good reasons for this. Japanese exporters, they contended, continue to have a competitive edge against their American counterparts. The source of this advantage is not price; nor is it quality. Unlike some other nations, American products continue to have a good reputation for quality in Taiwan. Rather the Japanese advantage is rooted in persistence and aggressiveness. It comes from a much greater willingness to go to Taiwan, learn the market, establish business relationships and nurture them. All of the major Japanese trading firms have branch offices in Taipei and employ substantial numbers of local people. The United States has nothing comparable. One government official stated the problem succinctly. There are 5,000 Japanese living in Taiwan, and they're mostly there to sell. The 1,000 Americans in Taiwan are mostly there to buy.

It is not hard to find reasons for these very different approaches. The United States domestic market is enormous, and of all the states, California has the largest share of that market. Most of our companies would prefer to concentrate on the familiar turf they find at home. But as foreign competition increases there, and as more and more nations follow the successful path of development blazed by Taiwan, Americans will have to do a better job of doing business abroad.

That means developing closer and stronger relationships with foreign business people. In the case of exporting to Taiwan, or investing there, that means frequently sending or stationing one's own sales representative or hiring a local agent. According to the U.S. Commerce Department, representatives must be able to discuss the latest developments in the potential customer's business. They are encouraged to hold demonstration seminars and distribute technical data and brochures to buyers, libraries, and industry associations. Commerce also strongly encourages making sales presentations at buyers' plants where one can meet with managers and engineers.

What happens after a sale is almost as important as what happens before it. Taiwan's citizens generally do not have the expertise required to maintain extremely sophisticated machinery, making exporters' assurances of reliable servicing and spare parts delivery extremely important. If exporters are unable to keep their own technical maintenance staff in the region, they must be willing to bring local staff to a plant in the U.S. for intensive service training.

What is at stake in understanding and succeeding in markets like Taiwan is our standard of living. To increase it -- to even maintain it -- we will have to improve our ability to do business abroad. We will have to become as adept in foreign marketing as foreign business people have become. That might be the most important message we heard on our trip. It is key to the relationship that California and Taiwan will have in the years to come.

A POLICY AGENDA

Our state and nation are fully capable of meeting the challenges of a rapidly changing, complex and competitive global trading system if there is sufficient will and determination. While our ultimate success will be determined in the private sector, the Advisory Council believes that the state and federal governments must play active roles in the formation of policies which promote international commerce and facilitate our participation in it.

The challenges posed by our trading partners, including Hong Kong and Taiwan, must be taken seriously. They have more than adequately demonstrated their economic prowess to the world. We must demonstrate the same resourcefulness and creativity that has helped them to compete internationally. We must invest in programs and policies that keep us economically viable. Finally, we must critically evaluate our world trade performance -- our shortcomings as well as our achievements.

As the leading export state in the nation and the eighth largest economy in the world, California has every reason to be proud of its global business activity. However, this is not the time to be complacent. Other nations and states continue to challenge our global position. With the fastest growing population in the country we are also presented with some of the greatest challenges in our history. Do we have the resolve to meet these challenges while maintaining our competitive position in the global marketplace?

A. NEW STATE INITIATIVES

The best way for California, and for that matter most other states, to improve that performance is to increase the numbers of small- and medium-sized businesses that market abroad. Only a small fraction of those companies actually realize that potentiality. According to the Commerce Department, about 85% of all U.S. exports originate from only 250 companies. And less than 10% of domestic manufacturers that could export actually do.[50]

Many of those companies that fail to export have marketable products. What they lack is a sense of the market abroad -- a feel for what is in demand in places like Hong Kong or Taiwan and a stronger grip on the customs and practices involved in selling in those nations. Often their reluctance to get involved in international commerce is based on the mistaken notion that the barriers are just too difficult to overcome.

The Advisory Council believes that California state government can take a number of steps to enhance the ability of small- and medium-sized companies to market internationally. It will also have to institute some major changes in policy if it is to maintain its economic leadership into the next century.

1. INCREASE SUPPORT FOR OVERSEAS TRADE AND INVESTMENT OFFICES AND ESTABLISH A NEW OFFICE IN TAIPEI

California takes justifiable pride in its growing network of overseas offices designed to assist California businesses to expand their global markets while at the same time actively encouraging foreign nationals to invest here in California.

Much of the impetus for overseas offices was based on the realization that other states and other nations were being much more aggressive in their international marketing and investment attraction strategies. By 1986 thirty-one states already had overseas offices. They were courting foreign investors and pursuing marketing opportunities with great success. Without an equally aggressive plan, California could not expect to maintain its ranking as both the leading export state in the nation and first choice for foreign investment.

Beginning in 1987, with the opening of offices in London and Tokyo, California demonstrated that it was up to the challenge posed by other states and nations. It was now ready to promote itself internationally. In 1989 other overseas offices were established in Mexico and Germany to capitalize on California's commercial ties with both it neighbor to the South and with the European Community. Finally, early in 1990 a Hong Kong office was established to serve more effectively California's interest in Pan-Asian business development. The Advisory Council strongly supports the decision to open a Hong Kong office. It is a further indication that East and Southeast Asian economies offer opportunities which have yet to be fully tapped.

The Advisory Council believes that the level of state support for these offices must be significantly enhanced as global competition increases and foreign markets assume greater importance in our economic development plans. The Council supports a doubling of the overseas office budgets within the next two years from approximately $2 million to $4 million.

California's reliance on international trade and the jobs and revenues it generates necessitates greater infusion of funds to support this critically important state program. The 1989-90 budget for these offices totaled $1.9 million as followed: Tokyo: $694,000; London $449,000; Mexico City: $368,000; Hong Kong $196,000 (6 months funding); and Frankfurt: $193,000

(9 months funding). The 1990-91 state budget of $1.979 million provides only a small augmentation in the overseas office budget. The Advisory Council on Asia is concerned about the Asian trade and Investment offices and believes this is an advantageous time to increase state support. Additional markets have been opening up in Asia, tariffs on many products are being reduced, quotas are being eliminated or modified and the Taiwan currency has appreciated nearly 50% since 1985, making our products more competitive. All this is good news to our exporters. What is missing is the necessary overseas support structure that will allow our business community to take full advantage of new opportunities in Asia. With federal government support for overseas marketing assistance continuing to erode, California's own program becomes all the more vital.

A Taipei Office

For several years the Legislature of the state of California has been supporting various bills and resolutions aimed at influencing the Executive Branch to open an office in Taipei or at a minimum to establish an automated trade showcase at the Taipei World Trade Center. The Legislature supported by various segments of the international trade community has long recognized the potential that exists in Taiwan for increased trade flows and the role it could play in facilitating trade with the rest of East and Southeast Asia, particularly now that Taiwan officials plan to transform its three export processing zones into free trade zones sometime before 1997. This action will dramatically strengthen Taiwan's position as a gateway to trade for all of Southeast Asia. California should position itself to take advantage of these opportunities for trade enhancement.

The states that have established offices report that they have paid substantial dividends. The state of Utah's International Department, for instance, says its Taipei office generated $18 million in non-agricultural exports to Taiwan in 1988. Utah officials also credit the office with playing a key role in convincing a Taiwan manufacturer to invest $20 million in the state.

Given California's inaction, the city of San Francisco -- Taipei's sister city -- has now decided to open an office of its own at the Taipei World Trade Center. It joins the city of Tucson, Arizona, and 13 other states which have already taken similar action. The decision of the city of San Francisco is based on sound business principles. As our trade with Taiwan expands and its investment in California accelerates, San Francisco wanted to be able to take full advantage of new commercial opportunities. The Advisory Council believes the city of San Francisco's action is worthy of state emulation. It calls on the Governor's Office, the World Trade Commission and the Department of Commerce to begin making plans to open an office at the Taipei World Trade Center within the next fiscal year. It also calls on the state of California to work cooperatively with San Francisco to coordinate efforts and avoid duplication once the state office is established. It further recommends that the California State World Trade Commission, along with the California Department of Commerce, study the feasibility of establishing additional trade and investment offices to determine appropriate locations.

2. PLAN FOR A NORTHERN CALIFORNIA EXPORT DEVELOPMENT OFFICE

Since 1985 the World Trade Commission has operated an Office of Export Development (OED). Originally operating out of Sacramento, it moved into new headquarters at the World Trade Center of Long Beach two years ago. The office is designed to assist smaller exporting companies and potential exporters. It organizes California's participation in numerous foreign trade shows and trade missions, develops California product catalogs, distributes trade leads through an automated trade leads system (ATLS) that matches foreign purchase inquiries against an in-house database listing of over 40,000 California suppliers and works closely with numerous foreign buyer missions.

The Advisory Council on Asia recommends the Export Development Office begin assessing the feasibility of establishing a second office in Northern California. The feasibility study should determine if a Northern California office would be better able to serve the interests of California's manufacturers and exporters, particularly those located in the Silicon Valley. This augmentation of state-level services would be especially important if the U.S. Department of Commerce does not increase substantially its funding for export promotion activities in-state and overseas.

3. DEVELOP COMPUTER LINKAGES WITH THE NETWORK OF STATE OVERSEAS OFFICES, THE U.S. AND FOREIGN COMMERCIAL SERVICE AND OTHER TRADE DEVELOPMENT AGENCIES

Instantaneous access to information is critical in a highly competitive international business arena. The Advisory Council on Asia recommends the Export Development Office devise a plan to link by computer the network of California overseas offices with its office, the Department of Commerce and the World Trade Commission in Sacramento, and the U.S. and Foreign Commercial Service. The Council believes that a better system for sharing information and providing it to potential foreign buyers and investors as well as California exporters could greatly enhance worldwide business opportunities. In addition, it would be worthwhile for OED to explore the possibilities of linkages with the offices of such foreign government trade development entities

as Taiwan's China External Trade Development Council (CETRA), the Japan External Trade Organization (JETRO), and the Hong Kong Trade Development Council (HKTDC). All are excellent models of government-sponsored export development agencies which offer highly sophisticated, well-staffed and comprehensive export-oriented services.

4. PROVIDE FULL FUNDING TO THE EXPORT FINANCE PROGRAM AND EXPAND THE OFFICES IN SAN DIEGO AND NORTHERN CALIFORNIA

The original legislation in 1985 which created the California Export Finance Office and fund provided $10 million for this purpose. However, in signing the legislation the Governor reduced the fund to $2 million, citing a need to see if the program proved itself before granting the full amount specified in the legislation. Although in subsequent years the fund has been gradually augmented -- standing now at $5 million, **the Council recommends the Export Finance Fund be fully funded at $10 million based on its demonstrated performance since 1985.**

We believe the program has proven itself to be immensely valuable in assisting exporters to gain the financing they need particularly in an environment in which many banks have been reluctant to make an export loan without the state guarantee. The program provides loan guarantees of up to 85% of working capital, accounts receivable or other pre-export financing to a maximum loan amount of $588,000. In addition, working with the U.S. Small Business Administration exporters may receive export loan guarantees for transactions up to $1,176,000. According to the World Trade Commission the CEFO has supported export sales of more than $240 million with a direct employment impact of 5,700 jobs.

A $10 million revolving account for loan guarantees would lend greater credibility and confidence on the part of the banking community and the CEFO would be able to maximize leveraging of the fund. The end result with be more export transactions.

Secondly, the Council recommends the World Trade Commission take steps now to expand the CEFO in the San Diego area and Northern California. We support making the San Diego Office a full-time operation so that it may handle the volume of business being generated by the high-tech and bio-tech industries in the San Diego region. We also propose that the two-person staff in the Northern California branch of the CEFO be increased to permit the hiring of a staff person who would work primarily with Silicon Valley firms.

5. EMPLOY THE TALENT OF CALIFORNIA'S ASIAN BUSINESS COMMUNITY

California, already the most ethnically diverse state in the nation, is fortunate to have a large and growing Asian population. It is a resource few other states can match, and it is one which could facilitate California's international business expansion. For example, many of California's Chinese-Americans have close business and personal ties to Hong Kong and Taiwan. Their cultural understanding of the people, language facility and business acumen could help others to penetrate these markets. Other Asian-Americans could perform the same function in other areas of the Far East.

As California continues to develop its Asian business connections, it must learn how to utilize this talent pool more effectively to sustain its economic well-being and to forge closer and more productive alliances. **The Advisory Council on Asia recommends an expansion of the Council's trade development function and role as a resource to the international business community and to state agencies involved in global commerce.** The council will actively work to develop and implement programs that make California's business ties with Asia even more productive. The Council also plans to develop closer working relationships with members of the California State Legislature and the California Congressional delegation to implement sound trade policies and to avoid protectionism.

As a first trade development project the Council plans to facilitate an environmental trade mission to Taiwan and Hong Kong as a way of encouraging California's numerous environmental consulting firms and related businesses to participate in specific Asian business opportunities. Taiwan and Hong Kong are now placing increasing emphasis on environmental quality issues such as air, water and ground pollution, waste reduction, the disposal of hazardous materials, recycling and mass transit. These policy decisions are creating exceptional opportunities for California-based firms which have the needed technical expertise and experience.

6. CONFORM STATE AND FEDERAL LAWS WITH REGARD TO THE TREATMENT OF SMALL FOREIGN SALES CORPORATIONS (FSC) AND ESTABLISH A STATE-SPONSORED "SHARED" FSC

Existing federal tax law provides special tax incentives to qualifying exporting firms organized as FSCs. **The Advisory Council recommends the California State World Trade Commission conduct a thorough review of the feasibility of incorporating into state law specific provisions of federal law which allow smaller export firms an exemption from federal tax of 15% of the profits earned from exports. The review should be completed in**

time to allow for the introduction of legislation during the first year of the new legislative session.

Allowing this exemption at the state level could act as an additional inducement for California's smaller companies to become involved in exporting. As a small FSC (gross receipts of less than $5 million annually) a company would not have to meet the requirement imposed on regular FSCs that management and other economic activities occur outside the United States. The Advisory Council believes the decrease in state tax revenues -- estimated in 1988 by the Franchise Tax board at $11 million for fiscal year 1990-91 -- would be more than offset by increased export transactions in subsequent years.

In addition the Advisory Council calls on the commission to review the benefits of the state becoming an active participant in the formation of a "Shared" FSC. The federal tax code permits up to 25 small exporting firms to join together and operate a "Shared" FSC. Delaware is one state that has already instituted a "Shared" FSC program. It is helping exporters by simplifying management and reducing overall costs for participation. Through a survey Delaware found out that many of its exporters were not knowledgeable about the tax advantages of an FSC. Those who were still did not take advantage of the tax benefits because they felt the provisions were too complex and burdensome. A "Shared" FSC retains the tax benefits of the FSC while greatly reducing the organizational burden, start-up fees an annual maintenance costs which would be split among many smaller exporter shareholders.

<u>A Model State-Sponsored Shared FSC</u>

Since last April the four California World Trade Center Associations have been helping the national organization market its shared FSC. However, the program is open only to members of the association. We believe that there is a legitimate role for a state agency in promoting and actually establishing "Shared" FSCs. **One possible arrangement which appears feasible and which should be investigated by the California State World Trade Commission is to incorporate the program into the existing California Export Finance Office (CEFO).**

We believe that the State of California could develop and put into operation a "Shared" FSC to complement its existing activities. One model would have the state providing the technical expertise to the exporters wishing to become part of the group while also maintaining a supervisory and advisory role in the program. Other models would have the state work with a region or governmental subdivision -- a city or county -- or a trade organization such as the California World Trade Center Association. The state would assist them in the development, implementation and marketing of one or more "Shared" FSCs. It may even contract with the association for specific FSC services so that the activity stays within state. Whatever model is finally determined most feasible for our exporters, the concept is sound and the benefits real.

7. INTERNATIONALIZE THE CURRICULUM AND PLACE GREATER EMPHASIS ON SCIENCE AND MATHEMATICS

Adopting short-term policies will unquestionably help our state and nation improve export marketing capabilities in Asia and elsewhere. However, if our nation is ever going to be able to fully realize its export potential, we will have to make changes far more profound than simply improving the performance of the government agencies mandated to assist private business and improving infrastructure. In the long run, we will have to develop an "export mentality." That means significantly increasing our ability to do business abroad by sharply boosting the number of Americans who speak Asian languages. It means increasing our understanding of, and familiarity with, business and social practices throughout Asia. It also means a new emphasis on math, science, geography and Asian history at all levels in the educational system.

The Advisory Council on Asia recognizes these changes will not be easy or inexpensive. Failure to initiate these reforms will have long lasting implications for our future competitiveness.
The Advisory Council believes that the following steps should be taken now to improve our educational system.

Train Teachers to Internationalize the Curriculum

Education depends on capable instructors. Before students can better understand their place in the world and come to appreciate the languages, cultures and history of others, teachers must be trained to internationalize the curriculum. If they lack the skills and tools needed to accomplish this goal, we can expect little from their students. As a first step in making the curriculum more responsive to the changing dynamics of a more integrated global community, **the Advisory Council supports full funding for 18 teacher resource centers throughout the state as originally intended by the Legislature when it passed AB 2543 by Assemblyman Sam Farr in 1985 (Chapter 1173, Statutes of 1985). The Council also supports restoration of the $950,000 in General Funds vetoed by the governor from the 1990-91 budget to support the existing nine centers.**

Emphasize Asian Languages and World Geography

The Advisory Council, echoing sentiments expressed by the California-Pacific Year 2000 Task Force, recommends greater emphasis be placed on foreign languages and geography in California schools. Currently, state law only requires California students to have a single year of either foreign language or fine arts, although the state Board of Education recommends two years of foreign language study. There is no requirement to study geography or Asian history.

The educational system must begin now to encourage the study of Asian languages. At present, only 1,196 California high school students study Chinese. Just 1,213 are studying Japanese. Too often there is the tendency to think that because English has become the language of international business, there is no need to learn another language. It is an erroneous belief and one which severely restricts our ability to do business on a global scale. Likewise we are hampered by our general lack of knowledge about other countries. **Students who remain insular, almost oblivious of other lands and peoples and how they interrelate, have closed the doors on their futures.**

Require Additional Math and Science Study

The jobs that will be most in demand in the year 2000 -- systems analysts, programmers, electrical engineers, etc. -- will almost universally require substantial math and science skills. Yet current state law only requires students to take two years of math and science to graduate from high school. That is insufficient to meet the demands of a sophisticated, high-tech society.

Expand the School Year

Japanese students spend approximately 240 days a year in the classroom. Americans spend about 180. It is difficult to see how we can match Japan's educational achievements if we do not even come near to matching the time they spend in the classroom. Significantly expanding the school year will not be easy, and it certainly will not be cheap; but it is imperative if we hope to keep up with the rest of the world.

State Internships

As the eighth largest economy in the world California already has a number of state agencies actively involved in export promotion and foreign investment attraction. We believe those agencies which have international programs should develop formal internship and cooperative study programs with the University of California, California State University and the California Community Colleges. **In particular, the Council believes the World Trade Commission's Office of Export Development could play a major role in developing a model student internship program.** Once developed the program could be replicated by other departments, offices and committees within the Executive and Legislative branches of state government including:

- -- the Department of Agriculture's export marketing program
- -- the Energy Commission's Alternative Energy Technologies Export Program
- -- the Department of Commerce's Office of Foreign Investment
- -- the World Trade Commission's Export Finance Program and International Visitors Program
- -- the Office of California-Mexico Relations
- -- the Senate and Assembly Offices of International Relations
- -- various standing, select, and joint committees of the Legislature whose jurisdiction covers international commerce and related matters.

8. IMPROVE INFRASTRUCTURE: CONSOLIDATED TRANSPORTATION CORRIDOR (ALAMEDA CORRIDOR)

The Advisory Council on Asia recognizes that no economy -- particularly one which is dependent on international business -- can sustain its vitality if it allows its infrastructure to deteriorate. To keep competitive into the 21st century, California must be willing to invest in improvements in its roads and highways. Likewise airports and seaports must be modernized and, in many cases, expanded. Looking at the vast sums that Hong Kong and other export-oriented economies are spending on infrastructure improvements only reinforces the need for California to make a similar investment in its future.

Consistent with this aim is the Consolidated Transportation Corridor (CTC) Project. **The Advisory Council on Asia strongly endorses plans for a $500 million program of highway and railroad improvements between the San Pedro Bay Ports and downtown Los Angeles.** We believe the project will greatly facilitate port access and port expansion while lessening highway traffic congestion, air pollution, vehicle delays at grade crossings and train noise and vibration impacts in residential areas.

We believe it represents a commitment to keep pace with the demands of international commerce through our ports by connecting the economic center of the San Pedro Bay Ports -- the largest port complex in the nation -- to the interstate highway system and national rail system. We also believe that the widening of

Alameda Street to a 4-6 lane highway will increase access to and through corridor cities.

The entire corridor project is expected to have the following economic impact:

-- a $46 billion increase in economic output in the five-county Southern California area between 2000 and 2020.

-- an estimated $966 million in additional wages and $2.9 billion in additional economic output in 2022.

-- enhanced employment and redevelopment opportunities resulting from improvements along the corridor.

-- an additional 37,000 trade-related jobs.

-- 5,000 new construction-related jobs.

Secondly, the Advisory Council strongly supports the concept of the proposed "2020 Plan" -- a $4.8 billion program to expand the land and terminal areas of the Ports of Long Beach and Los Angeles and in general increase economic activity throughout Southern California. We believe that port enhancement is a critical part of California's effort to maintain its international competitiveness and must be given high priority. The project takes into consideration the expected increase in Pacific Rim trade within the next 20 years which is so vital to the California economy.

B. FEDERAL LEVEL INITIATIVES

9. EXAMINE THE IMPACT ON THE CALIFORNIA ECONOMY OF THE IMMIGRATION REFORM ACT OF 1990

The recently-signed Immigration Reform Act of 1990 substantially revises the legal immigration program. It more than doubles (from 54,000 to 140,000) the number of visas available annually for immigrants coming here to work and who have important skills and professional expertise, increases immigration from countries currently providing few immigrants, and increases the number of visas for family reunification. Visas for immigrants from Hong Kong would rise from 5,000 to 25,000 annually by 1994. An additional 12,000 immigration visas would be provided for Hong Kong residents employed by U.S. companies and who could be similarly employed in the United States in fiscal years 1992 through 1994. Total worldwide immigration would be limited to 675,000 annually, excluding refugees or legal aliens.

A key provision of the Act is the creation of a special "investor" visa category (10,000 annually) for foreigners investing $1 million in U.S. businesses (or $500,000 in rural areas with high unemployment) and creating a minimum of 10 new jobs.

The Advisory Council intends to undertake a major review of these reforms and innovations in immigration policy to determine how they may benefit California and be incorporated into the state's overall economic development strategy. The Council believes it is in California's best interest to attract this investment and direct it to areas where there is excessive unemployment or underemployment.

OTHER FEDERAL INITIATIVES:

The Advisory Council on Asia has reviewed and strongly endorses a number of federal-level recommendations contained in California and the Pacific in the New Century: A Strategic Plan for Success by the California-Pacific Year 2000 Task Force. Among its recommendations, the Advisory Council singles out the following for greater emphasis:

10. INCREASE SUPPORT AND EXPAND THE LOCAL AND FOREIGN STAFFS OF THE U.S. & FOREIGN COMMERCIAL SERVICE, INTERNATIONAL TRADE ADMINISTRATION

For a country that likes to think of itself as making a serious effort to improve its export position and the ability of its smaller companies to become exporters, the United States has been following some very contradictory policies. One of the most self-destructive is that we have sharply reduced the budget of the U.S.& FCS of the International Trade Administration -- the Commerce Department agency responsible for analyzing foreign markets and informing American businesses of the opportunities available in them.

The ITA has been forced to cut personnel both here and abroad. Such shortsighted action does nothing for our future competitiveness. By comparison, last year the Japanese stationed nearly 6,000 commercial service personnel abroad to 723 for the United States. At home, the situation is not much better. California's ITA offices in Los Angeles, San Francisco, San Diego, and Santa Ana are badly understaffed and service is poor. Staff is frequently unable to provide companies with the service they need.

Changing that will not be easy in view of the federal government's fiscal situation. However, compared to many of the other items on the federal budget, the International Trade

Administration's appropriation is minuscule. Increasing it is an investment that will pay dividends far greater than the original cost.

The Advisory Council endorses the recommendations made by the California-Pacific Year 2000 Task Force to increase funding and staffing of these offices both in California and abroad.

11. REDUCE THE BUDGET DEFICIT

This proposal is certainly not original but it is the core of our economic viability. A nation cannot build a competitive international economy if it runs budget deficits as large as those the federal government continues to generate. Those deficits inhibit every facet of our economy and leave a massive burden of debt on future generations, further eroding our basic quality of life and living standards.

12. INCREASE RESEARCH AND DEVELOPMENT

The production of technologically superior products cannot be accomplished without constant research. In recent years the United States has failed to commit the resources to critical R&D. While the United States continues to outspend Japan and Germany in R&D, a large share of that spending goes to defense projects which have very limited civilian applications. When only non-defense R&D is counted, we are spending about the same amount as both Japan and Germany. Moreover, during the last decade those countries had increased their spending much faster than we had boosted ours.

The Advisory Council on Asia supports both the creation of an "Advanced Civilian Technology Agency" to assist the private sector in developing critical technologies that are commercially viable and the creation of a "Technology Corporation of America" to promote the development of strategic industries particularly in high technology area.

13. CONTINUE TO OPEN FOREIGN MARKETS

Overall prospects for California manufactured exports and agricultural commodities are improving. Credit must be given to U.S. trade officials and representatives in bilateral and multilateral trade negotiations (GATT) and such important legislative initiatives as the Omnibus Trade and Competitiveness Act of 1988. **While acknowledging that positive steps have been made, the Advisory Council endorses continued action by the United States Trade Representative (USTR) and other trade officials to eliminate remaining barriers to trade.**

Appendix A

INDIVIDUALS INTERVIEWED IN HONG KONG

S.K. Chan, Executive Director, Hong Kong Productivity Council
Lucia Sedwick Claster, Manager, Trade and Business Promotion, American Chamber of Commerce, Hong Kong

Chen Zhesheng, Head of Economic Affairs Department, Xinhua News Agency, Hong Kong Branch

Patrick W. Chung, Principal Consultant, Inward Investment Division, Hong Kong Government Industry Department

Guo Hongxun, Vice Managing Director, China Merchants Holdings Co., Ltd.

Ian Howard, Assistant Director, Investment Promotion, Hong Kong Government Industry Department

Christopher I.C. Jackson, Assistant Director, Hong Kong Government Trade Department

Anna Lai, Chief Economist, Hong Kong Trade Development Council

S.P. Lau, Assistant Director, Hong Kong Trade Development Council

Paul Loh, Manager, Hong Kong Trade Development Council

Herbert H.Y. Liang, Chairman, The Wider Enterprises Ltd.

F.S. Lin, Director, The Chinese Manufacturers' Association of Hong Kong

Ned Quistorff, Commercial Officer, American Consulate General

Susan Scurlock Theiler, Foreign Agricultural Affairs Officer, American Consulate General

Tong Zhiguang, President, China Resources Holdings Co. Ltd.

Zhang Xueyao, Director, Board of Directors, General Manager, Hong Kong Branch, Bank of China

Zheng Hua, Vice Director, Xinhua News Agency, Hong Kong Branch

Appendix B

INDIVIDUALS INTERVIEWED IN TAIWAN

Pin-Kung Chiang, Director General, Board of Foreign Trade, Ministry of Economic Affairs

Ronie H.K. Huang, Deputy Secretary General, China External Trade Development Council

John C.I. Ni, Director General, Industrial Development and Investment Center, Ministry of Economic Affairs

Agustin Tingtsu Liu, Secretary General, China External Trade Development Council

Liu Shoou-Kuen, Board of Foreign Trade, Ministry of Economic Affairs

Charles L. Shyu, Director of Third Department, Board of Foreign Trade, Ministry of Economic Affairs

Chien-Shien Wang, Vice Minister, Ministry of Economic Affairs

Frank S. Wang, Managing Director, China Rebar Company

Yu Ming-I, Director, Income Tax Division, Ministry of Finance

Appendix C

FOREIGN GOVERNMENT AND TRADE SERVICES OFFICES IN CALIFORNIA

HONG KONG

Hong Kong Economic and Trade Office -- Provides information about Hong Kong governmental developments; monitors trade and economic developments in the United States and proposed state and federal legislation that might affect Hong Kong's economic interests and bilateral trade.

San Francisco -- (415) 397-2215

Hong Kong Trade Development Council -- a statutory body responsible for promoting and developing Hong Kong's overseas trade and publicizing the opportunities and advantages of Hong Kong as a trading partner. Members include representatives of major trade associations, leading business people, industrialists and government officials. Twenty-nine worldwide offices provide up-to-date trade and economic information and offer advice to people interested in developing trade with Hong Kong.

Los Angeles -- (213) 622-3194

TAIWAN

Coordination Council for North American Affairs (CCNAA). In lieu of official diplomatic relations, the Council represents Taiwan's political and economic interests in the United States.

Los Angeles - (213) 389-1215/San Francisco - (415) 362-7680
Commercial Division -- (213) 380-3644
Information and Communication Division -- (213) 461-3665

Far East Trade Services -- Part of the China External Trade Development Council (CETRA) -- Taiwan's foremost trade promotion organization operates 28 offices in 23 countries. Among other activities, it provides trade leads and general economic information on doing business with Taiwan, organizes trade groups and fact-finding missions, offers seminars and sponsors product exhibits.

San Francisco (415) 788-4304

Appendix D

KEY AGENCIES IN CALIFORNIA

A. FEDERAL

International Trade Administration, United States Department of Commerce -- Has access to all export assistance and information offered by Commerce Department

Los Angeles -- (213) 209-6707
Santa Ana -- (714) 836-2461
San Diego -- (619) 557-5395
San Francisco -- (415) 556-5860

Export Licensing Offices:

Santa Clara -- (408) 748-7450
Newport Beach -- (714) 660-0144

B. State of California:

1. **CALIFORNIA STATE WORLD TRADE COMMISSION (CSWTC)** -- leading export promotion agency for California. Provides a variety of services to California exporters through several programs:

Headquarters and Office of Trade Policy
Sacramento - (916) 324-5511

Office of Export Development
Long Beach - (213) 590-5965

Export Finance Offices
Los Angeles - (213) 620-2433
San Francisco - (415) 557-9812

Federal Liaison Office
Washington, D.C. (202) 347-6891

2. **CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE**, Agricultural Export Program
   Sacramento - (916) 322-4339

3. **ENERGY COMMISSION**, Energy Technology Export Program
   Sacramento - (916) 324-3449

4. **DEPARTMENT OF COMMERCE**, Office of Foreign Investment
   Sacramento - (916) 322-3518

Appendix E

CALIFORNIA OVERSEAS TRADE AND INVESTMENT OFFICES

Europe

14 Curzon Street
London W1Y7FH, United Kingdom
Tel: (011) 44-071-629-8211
Fax: (011) 44-071-629-8223

Bockenheimer Landstrasse 98
6000 Frankfurt/Main 1
Tel: (011) 49-69-74-64-36
Fax: (011) 49-69-75-60-0637

Asia

Kowa 35 Building Annex
1-14-15 Akasaka
Minato-ku, Tokyo 107, JAPAN
Tel: (011) 81-3-583-3140
Fax: (011) 81-3-584-6613

Suite 301, St. George's Building
2, Ice House Street
Central, HONG KONG
Tel: (011) 852-877-3600
Fax: (011) 852-877-2691

Mexico

450 Paseo de la Reforma
06600 Mexico, D.F., Mexico
Tel: (011) 52-5-208-5161
Fax: (011) 52-5-208-5761

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4. Hong Kong Trade Development Council

5. See reference 1, pp. 84-85

6. California State World Trade Commission

7. Business America, May 23, 1988, p. 4

8. See reference 3

9. See reference 1, p. 60

10. Los Angeles Times, (Hong Kong Supplement), May 1, 1990

11. See reference 10

12. See reference 10

13. See reference 7

14. See reference 1

15. See reference 1

16. See reference 4

17. Information supplied by the Bureau of Economic Analysis, U.S. Department of Commerce, Washington, D.C.

18. See reference 17

19. See reference 1

20. See reference 17

21. Information supplied by the California Department of Commerce, Sacramento

22. See reference 10

23. See reference 3

24. Foreign Trade Development of the Republic of China, Ministry of Economic Affairs, Taiwan, (1990)

25. Information supplied by the California State World Trade Commission

26. Information supplied by the Commercial Division, Coordination Council for North American Affairs, Los Angeles

27. See reference 25

28. See reference 26

29. See reference 24

30. See reference 26

31. ROC-USA Trade Relations, Board of Foreign Trade, (May 1989)

32. See reference 26

33. See reference 26

34. See reference 33

35. See reference 33

36. See reference 33

37. See reference 33

38. See reference 24

39. Free China Journal, August 23, 1990

40. China Economic News, Hong Kong, (March 1989)

41. See reference 33

42. See reference 26

43. See reference 1, p. 273

44. See reference 1, pp. 405-406

45. See reference 33

46. Los Angeles Times, D1, May 14, 1990

47. See reference 46

48. See reference 46

49. See reference 46

50. Business America, May 8, 1989, p. 8